No. 12491.

In the

United States Court of Appeals

For the Ninth Circuit

PICKERING LUMBER CORPORATION, a Corporation, *Appellant,*

vs.

THE AMERICAN INSURANCE COMPANY, ET AL., *Appellees.*

APPELLANT'S BRIEF.

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STATEMENT OF THE PLEADINGS AND FACTS DISCLOSING THE BASIS UPON WHICH IT IS CONTENDED THAT THE DISTRICT COURT HAD JURISDICTION, AND THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENT.

Appellees, being thirty-six fire insurance companies, commenced this action in the District Court of the United States for the Northern District of California, Southern Division, by complaint asking a declaratory judgment determining a report of appraisers, appointed pursuant to the appraisal provisions of policies of use and occupancy insurance issued by them to appellant, to be valid and binding upon the parties (R. 2-15).

Appellant filed its answer, and counterclaim in two counts (R. 49). The answer denied the award was valid and binding upon the parties. The first count of the counterclaim (R. 53), briefly summarized, alleged that the ap-

praisers misconceived their duties, and mistook and exceeded their authority, and failed to discharge the submission, and undertook to construe, and misconstrued, provisions of the policies, and committed and acted upon fundamental gross errors of law, and omitted items of loss insured by the policies, and made calculations upon unlawful and erroneous bases, in that:

(1) They failed to find and state (a) the amount of extra logging expense incurred by appellant after the fire, in partial logging operations to reduce loss; (b) the amount of expense incurred by appellant in extending its decking yard, and logging railroad tracks therein, to "deck" the logs brought in to the millsite after the fire in partial logging operations to reduce loss; and (c) the amount of depreciation that accrued in the nine months loss period after the fire on the logs on hand at the time of and after the fire; and the appraisers, without making any computation respecting, and without finding the amount of, these items, and doubting them to be covered by the policies, made an arbitrary, unauthorized and void lump sum compromise, at $25,000.00, of those items aggregating $91,439.34, to appellant's injury in the amount of $66,439.34;

(2) They, in violation of the submission, and contrary to law, charged appellant's box lumber into its box shook mill, in its partial operations after the fire to reduce loss, at OPA ceiling prices, rather than at appellant's cost therefor, which ceiling prices were $8.31 per thousand feet less than appellant's cost for the box lumber, thus fictionally increasing the amount of box mill profits to be credited against appellant's claim by $8.31 x 8,828,644 feet, or $73,365.93, to appellant's injury in that amount; and

(3) They added to annual values in the year after the fire unreal depreciation on the destroyed sawmill for the year after its destruction by fire in the amount of $15,042.17 when no such depreciation occurred, thus injuring appellant, under the contribution clause of the policies, in the amount of $8,001.44.

The second count of the counterclaim (R. 74) was an action, in conventional form, upon the policies.

At pretrial conference it was agreed by the parties to try before the court, at this trial, only the issues of plaintiff's complaint and of the first count of appellant's counterclaim (R. 364), trial of the second count of appellant's counterclaim to await the result of this trial.

This trial was commenced on June 7th, and was concluded and taken under submission by the court on June 13, 1949. On December 23, 1949, the court rendered and filed his opinion (R. 103) holding the report of the appraisers to be valid and binding upon the parties, and thereafter, on January 16, 1950, the court entered final judgment accordingly (R. 148), from which appellant, on January 30, 1950, took its appeal to this court (R. 152).

This being an action of a civil nature, and it being alleged in appellees' complaint (R. 3), and it being admitted in appellant's second amended answer and counterclaim (R. 49), that there is complete diversity of citizenship between appellant and each of the appellees, and that the amount in controversy between appellant and each of the appellees exceeds the sum of $3,000.00, exclusive of interest and costs, it follows that jurisdiction of this cause was conferred upon the District Court by Section 1332, Title 28, U. S. C. A., and jurisdiction to review its judgment is conferred upon this court by Sections 1291 and 1294, Title 28, U. S. C. A.

STATEMENT OF THE CASE.

Appellant owned and operated as an integrated business (R. 220, 449) a large lumber manufacturing plant, consisting of sawmill, dry kilns, planing mill, box shook mill, power houses, and similar structures, and extensive forests in connection therewith, at and near Standard, California (R. 176), and had purchased from each of appellees, on April 30, 1945, identical policies (except for names of issuer, policy number and amount) of indirect fire insurance (commonly called business interruption, or use and occupancy, insurance), aggregating $651,000.00, effective for a term of one year from April 30, 1945 (Par. IV of appellees' complaint, R. 6, 7, 8), insuring appellant against actual loss of net profits of its business, and against those fixed charges and expenses which must necessarily continue, sustained by reason of suspension, or partial suspension, of its business, caused by fire, in the following language:

"COVERAGE"—

"2 (A). The conditions of this contract are that if the buildings and/or structures and/or machinery and/or equipment and/or supplies and/or all that property upon which the printed conditions of this policy require that liability be specifically assumed and/or raw stock (all as now or hereafter existing); in, on and/or under 'Plantsite', 'Athletic Field' and 'Townsite' premises situate at and near Standard Tuolumne County, California, and occupied or used for woodworking or mercantile, or for any other purposes, including (but not limited to) townsite purposes or purposes incidental or related to such woodworking or mercantile operations, be destroyed or damaged by fire occurring during the term of this policy so as to necessitate a total or partial suspension of business, this Company shall be liable under this policy for the actual loss sustained by reason of such suspension, consisting of:

ITEM I. The net profits on the business which is thereby prevented;

ITEM II. Fixed charges and expenses, only to the extent to which they would have been earned had no fire occurred, as follows: Salaries of indispensable employees, superintendents, executives, salesmen and employees under contract, taxes, interest, rents, royalties, insurance premiums, depreciation, advertising, special contracts, dues, subscriptions, directors' fees, accounting expenses, legal expenses and fees, light, heat and power, and such other fixed charges and expenses which must necessarily continue during a total or partial suspension of business." (Plf's Ex. B, R. 30, 31.)

The loss period covered by the policies is set forth, in paragraph 3 of the mimeographed part of the policies, as follows:

"3. It is a condition of this contract that the length of time of suspension for which loss may be claimed:

(A) Shall not exceed seventy-five per cent (75%) of 365 calendar days;

(B) Shall not exceed such length of time as would be required with due diligence and dispatch to rebuild, repair or replace such property herein described as may have been destroyed or damaged;

(C) Shall commence with the date of the fire and not be limited by the date of expiration of this policy." (Plf's Ex. B, R. 32, 33.)

On July 7, 1945, while these policies were in full force (R. 177) the sawmill and some appurtenant structures were completely destroyed by fire (R. 177), which suspended all sawmill operations, but continuance of logging operations was not suspended by the fire (R. 179), and the box shook mill was not directly damaged and it again became operable in a few days (R. 179).

At the time of the fire appellant had cut and on hand about 9,550,000 feet of logs, 4,000,000 feet of which were in the pond at the millsite and the remaining approximately 5,500,000 feet were lying on the ground where cut in the forest (R. 185, 186).

Paragraph 10, of the mimeographed portion of the policies, provided that:

> "10. It is a condition of this insurance that as soon as practicable after any loss, the insured shall resume complete or partial operation of the property herein described, and shall make use of other property, if obtainable, if by so doing the amount of loss hereunder will be reduced, and in the event of the loss being so reduced such reduction shall be taken into account in arriving at the amount of the loss hereunder." (Plf's Ex. B, R. 35.)

In compliance with that provision of the policies and to get the approximately 5,500,000 feet of logs that were cut and still lying in the forests off the ground and into decks at the millsite, to arrest depreciation of them, appellant resumed logging operations a few days after the fire (R. 186, 187).

About July 12, 1945, appellant gave its order to Filer & Stowell, of Milwaukee, a large manufacturer of sawmill machinery, for the machinery for the new mill. The new mill was to have two band saws, or cutting sides, one larger than the other, and completion of the large side of the mill was promised by January 15th, or February 1st, 1946 (R. 184), and at about the same time appellant contracted with H. H. Larsen, a San Francisco contractor, to construct its new mill building and to have it ready to receive the new machinery as it arrived (R. 196).

The large side of the new mill would cut from 200,000 to 225,000 feet of lumber per day (R. 185) and, to provide enough logs to supply the contemplated partial operations of the new mill to the end of the nine months loss period under, and as required by, paragraph 10 of the policies, appellant decided to cut about six million feet more of logs (R. 186),[1] and actually commenced those logging operations on July 27, 1945 (R. 187).

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[1]Appellees' reply (lines 9 to 14 of R. 91) admits that "it appeared that one side of the sawmill could be rebuilt and put into operation within less than nine months of the date of the fire, thus permitting partial operation of the sawmill within the term insured by the policy."

To minimize depreciation on the logs to be cut, appellant moved the scene of its logging operations from the pine area, where it had been logging before the fire, to a fir area (R. 187), because it was obvious there would be more than normal delay in milling the logs (R. 188) and fir logs are not subject to as much depreciation as pine logs (R. 187), and they were then in the hot season and pine logs stain badly at that time of the year and "would be subject to terrible loss from depreciation" (R. 188).

The fir area was further from the central logging camp, where the loggers lived and where the trucks were kept at night, causing longer travel distances, and greater travel time, both for the men in getting to and from work and in trucking the logs to the logging railroad, resulting in less production per day; and the move necessitated additional expense in rehabilitating and extending the roads to and in the fir area before they could be used, and the operation, though to bring in a small amount of footage, required the same superintending and overseeing personnel as the normal maximum operation (R. 188, 189, 190), thus greatly increasing the cost per thousand feet of the partial logging operations.

On October 8, 1945, appellant received word that Filer & Stowell's employees had gone out on strike, and appellant ceased cutting logs on that day (R. 196). It had cut after the fire to that time slightly over 5,800,000 feet of logs (R. 190).

After the fire appellant brought in to the millsite 11,301,877 feet of logs (R. 190, 191), which were the approximately 5,500,000 feet of pine logs cut and on the ground at the time of the fire (R. 186) and the approximately 5,800,000 feet of fir logs that were cut after the fire (R. 190).

Appellant's fixed general logging overhead expense in the year preceding the fire (the agreed test year[2]) was $5.31993 per thousand feet, mill scale, and, having, after the fire, produced to the millsite 11,301,877 feet of logs, mill scale, it, pursuant to the requirements of paragraph 10 of the policies, credited its claim, in its proof of loss (Plf's Ex. D), with recovered continuing fixed charges and expenses from the partial logging operations in the *gross* amount of 11,301,877 feet x $5.31993, or $60,125.19 (R. 191 and the proof of loss, Plf's Ex. D, p. 20, Sch. III, and p. 21, Sch. R-1).

Normally appellant's logging costs declined in mid-season, but in this case, because of the required moving of operations from the pine to the fir area, and the consequent factors above-mentioned, logging costs substantially increased (R. 193, 372, 373). Appellant's logging costs in the year preceding the fire were $21.91339 per thousand feet but after the fire they were $25.51592 per thousand feet, or $3.60253 more per thousand feet (R. 192), and in its proof of loss (Plf's Ex. D,) it offset these extra logging costs against the *gross* recovery from partial logging operations in the sum of 11,301,877 feet x $3.60253, or $40,715.40 (R. 192; and the proof of loss, Plf's Ex. D, p. 22).

Appellant had to get these 11,301,877 feet of logs off the ground to minimize depreciation of them, and its mill pond was full of logs, so it had to put them in "decks"—

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[2]Under cross-examination by counsel for appellees, Mr. Momyer, appellant's auditor, testified: "Q. And that was agreed, was it not, in the adjustment of the U. & O. loss, that the experience of the year—the fiscal year ending March 31, 1945, would be used as the base year for the purpose of calculating the use and occupancy loss? A. I believe that was agreed by all parties" (R. 246). * * * "Q. That was the assumption both parties used—the appraisers used all the way through this appraisement, wasn't it? A. Yes" (R. 253). * * * "A. I am using the test year that was agreeable to all concerned at the time. Q. You mean to the insurance companies? A. Yes, they didn't challenge the use of that test year" (R. 325). "The court (interrupting): He did not say they did not. He said both sides agreed on the test year" (R. 326). "Q. But it is a fact, is it not, that the test year which all parties agreed was to be taken as the basis for calculation, did show an overrun at the box factory, did it not? A. I am sure that is true" (R. 427).

stack them up like cord wood—[3] but its decking yard was not large enough to accommodate so many logs and it was necessary for it to enlarge its decking yard and extend its logging railroad tracks thereto and therein and this cost it $12,492.35 (R. 194), and in its proof of loss appellant offset this sum of $12,492.35 against the *gross* recovery from partial logging operations.

The Filer & Stowell strike continued until April 1, 1946, and as a result the new mill machinery was not received and installed in the new sawmill until August 1, 1946, and the logs had to remain in decks, exposed to the weather, until that time (R. 196). It was obvious substantial depreciation had occurred in the logs (R. 197), and appellant could not make its proof of loss until it could determine how much depreciation had occurred in the nine months loss period after the fire (R. 197).

After the new mill became operable on August 1, 1946, to make the necessary test cuts, appellant told its problem to Western Pine Association, of Portland, Oregon, and it sent, about November 1, 1946, Mr. Lee Moffit and Mr. Henry Thomas, lumber experts, to make an analysis of the logs and the lumber they produced (R. 197, 198) and to determine the amount of depreciation that had occurred in the logs, and when it occurred (R. 368). Mr. Moffit "spot" selected from the decks a quantity of logs cut before the fire and a quantity of logs cut after the fire, 200,000 feet in all (R. 199), which were sawn under his supervision, and then analyzed by him for kind and extent of deterioration, and he then made the written report which is defendant's Exhibit 1 (R. 207-210).

Mr. Thomas then made an analysis of that lumber to determine what part of the deterioration occurred in the insured period of nine months after the fire and what

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[3]Appellees' reply (lines 17 to 24, R. 91) admits "that defendant did cut additional logs after the fire and before snch time as such operations would be halted by snow, and did haul logs from the woods which had resulted from cutting timber before the fire occurred, and did deck them at defendant's plantsite, and that such decking did arrest deterioration, decay, check and depreciation of said logs already cut."

part occurred thereafter, and he made the written report which is defendant's Exhibit 2 (R. 210-213).

These tests and analyses were made from November 1 to November 22, 1946 (R. 208). The insurance companies were invited to participate, but did not accept, saying they were not interested (R. 221, 222).

Mr. Momyer, appellant's auditor, received these reports and, following the findings and formula thereof, computed the dollar amount of the rot, stain, end check and like depreciation that had occurred, in the nine months loss period following the fire, on the 5,844,910 feet of logs cut after the fire, which amount was $2,081.64 (R. 213, 214), and appellant, in its proof of loss (Plf's Ex. D, p. 22, Sch. III-R1) offset this sum of $2,081.64 against the *gross* recovery from partial logging operations.

This produced the following summary of figures (R. 214, 215):

Gross recovery of fixed charges and expenses by partial logging operations after the fire of 11,301,877 feet x $5.31993 per M feet,		$60,125.19
Excess logging costs after the fire of 11,301,877 feet x $3.60253 per M feet, or	$40,715.40	
Extra decking expense	$12,492.35	
Depreciation on 5,844,910 feet of logs cut in partial logging operations after the fire	$ 2,081.64	$55,289.39
Leaving a net partial logging operations credit against the claim of		$ 4,835.80

Mr. Momyer then, following the findings and formula of the Moffit and Thomas reports (Defendant's Ex. 1, R. 207, and Defendant's Ex. 2, R. 210) computed the dollar amount of the rot, stain, end check and like depreciation that had occurred, in the nine months loss period

following the fire, on the 9,550,656 feet (R. 185) of logs that were cut before, and on hand at the time of, the fire, and claimed it in Schedule D-8, on page 17, of the proof of loss, as "depreciation" insured under "ITEM II" of the policies, in the resulting amount of $36,149.95 (R. 213).

We now turn to the subject of the box shook mill operations after the fire.

Appellant had produced and on hand at the time of the fire 8,828,614 feet of lumber suitable for cutting into box shook (R. 216). It had not produced this lumber for sale as lumber, and never offered it for sale, and it was not for sale, as lumber, but appellant had produced and held it for the supply of its box shook mill for cutting into, and sale as, box shook.[4]

Because of our government's great need for shipping crates, or boxes, in the war, it undertook to encourage the production and sale of box shook and to discourage the sale of box lumber, as lumber, by setting OPA ceiling prices at a high figure for box shook and at a very low figure for box lumber,[5] and as a result box lumber could

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[4]Mr. Momyer testified, at R. 215: "Q. And now, had Pickering Lumber Corporation produced that lumber itself? A. It had. Q. And for what purpose had it produced the so-called box lumber? A. For the use in a box factory, produced box shook. Q. Did it ever offer to sell that lumber as lumber? A. It did not. Q. And, of course, didn't sell it as lumber? A. No, sir. Q. You ran it through the box factory? A. That is right." At R. 216, he testified further: "Q. Did Pickering Lumber Corporation ever produce for sale, or offer to sell as far as you know, that type of lumber called box lumber? A. We did not."

[5]Mr. Momyer testified, under cross-examination by counsel for appellees (R. 390, 391): "Q. Now, Mr. Momyer, it was later, then, was it not, that the government decided to encourage the production of box shook, that is, the manufacturing process that took place, at the box factory, because of the fact that, as I believe is alleged at great length in the Pickering answer, that the shook was needed for shipment overseas, and that was after the OPA prices were fixed, wasn't it? A. I am sure it was. Q. In order to accomplish that result the government raised the ceiling on box shook, did it not? A. Yes, sir." At R. 442-443, appellees' witness Rodolph testified: "Q. Do you recall when it was that the raise in shook prices came about, about 1942? A. First of all, the shook prices were relatively low, and along in October or November of 1943, the OPA added table 3A to the price list which in itself raised the shook prices considerably. Q. Yes. And during the period of time during 1942 and 1944, did the OPA ceiling price of box lumber go up or down? A. They went up. Q. How much? A. About $3.00 per thousand feet. Q. In other words very little in

not be purchased at OPA ceiling prices.[6]

The box shook mill was not directly damaged (R. 178) and, in compliance with the requirements of paragraph 10 of the policies, its operations were resumed within a few days after the fire, for the benefit of the insurance companies (R. 217), and continued until the supply of box lumber was exhausted (R. 179), about March 16, 1946 (R. 221).

In that period the 8,828,644 feet of box lumber was run through the box shook mill and produced 8,636,974 feet of shook (R. 216), which was promptly sold for $60.22 per thousand feet.

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comparison with the raise in ceiling prices of shook? A. That's correct."

On cross-examination, Mr. Rodolph testified, at R. 457: "Q. Now, of course, we had very abnormal conditions in the lumbering industry, and particularly in the box shook end of it, during OPA prices and the duration of the war, didn't we? A. Yes. Q. And there was a great demand on the part of the government for boxes, was that not true? A. Yes." And further (R. 458): "Q. Now there were great scrambles during the period of the latter years of the war, especially existing in 1945, for people trying to get lumber to make boxes or box shook, wasn't there? A. For all lumber, yes."

Appellees' reply admitted (lines 3 to 16, R. 96), "that the United States government placed OPA ceiling prices on box shook which would permit the sale of box shook at a good profit, and that generally other grades of lumber could not be sold at prices which would realize as great a profit as could be realized by the manufacture and sale of box shook; that during the entire 9-month period following the fire, lumber to be used for the manufacture of box shook was of greater value to defendant than lumber to be sold after it had passed through the sawmill and the planing mill because under OPA ceiling prices a greater profit could be made upon the lumber manufactured into box shook."

[6]Mr. Momyer testified (R. 215, 216): "Q. * * * I believe this is covered by the pleadings, but I want to cover it briefly, was it possible to buy box lumber at the time of or following the fire at OPA ceiling prices? A. It was not possible." He further testified (R. 251) that he felt Pickering should not have to use all its box lumber in partial operations after the fire "because it could not be replaced," and that it "could not be purchased on the market."

This is admitted by lines 9 to 15 of paragraph 11 of appellees' reply (R. 95) as follows: "Except that plaintiffs admit that the United States was at war with the governments of Germany and Japan; and as to the allegation contained in the second sentence about the middle of page 17, reading 'Such lumber could not be bought in the market or for the prices which might lawfully be paid under OPA regulations.'"

Mr. Herrick testified (R. 547): "Q. Do you remember there was evidence to the effect that Pickering couldn't have bought the lumber that went to the box factory at OPA ceiling prices? A. Yes. Q. Did the appraisers question that testimony? A. No, not only did the appraisers not question it, but it was within their general knowledge. Q. They knew that was a fact? A. Yes."

Appellant's costs for its lumber to the "diversion point" (the green sorter behind the sawmill where the lumber is sorted and roughly classified) were the same on all the number it produced,[7] that cost was $37.39 per thousand feet (R. 282, 283), its cost for treating, handling and transporting the box lumber to the box shook mill was $2.41 per thousand feet, and hence the cost of that lumber to the box mill door was $39.86 per thousand feet,[8] its costs for sawing the lumber into the shook were $11.65 per thousand feet, its shipping costs were 97c per thousand feet, and the under-run (waste) amounted to $1.03 per thousand feet (R. 217, 218).

This produced the following summary of figures (R. 217, 218):

Cost for the box lumber to box mill door	$39.86	per M	
Cost of sawing into shook	11.65	" "	
Shipping costs	.97	" "	
Under-run	1.03	" "	
Total Cost	$53.51	" "	
Total Realization			$60.22 per M
Profit	$ 6.71	" "	
	$60.22		

$6.71 x 8,828,644 feet (all credited to the insurance companies) $59,240.93.

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[7]Mr. Momyer testified (R. 263): "To demonstrate, starting with the logs in the woods, all grades of lumber are in one package in the form of a tree. For the wood you cut in that tree you pay so much a thousand for the cutting of the tree regardless of how many grades are involved in that tree. You pick that log up and load it on a car and bring it down to the mill, still in one package, you send it through the saw and you get various grades of lumber from that log. But I defy anyone to show that one board in that log costs you more than another board in the log, regardless of what it sells for."

[8]Mr. Momyer testified (R. 217): "Q. And now, in constructing your claim, the proof of loss, would you tell us how it was done? A. We first took the cost of 8,828,644 feet of lumber, used in the box factory, that was $39.86 per thousand feet, and to this added the cost of manufacture in the box factory, the work of processing the lumber through the box factory unit, that was $11.65. * * *, and the shipping expense, $.97 per thousand, and then because we didn't get the full 8,828,644 feet in shook, we had an under-run of 191,670 feet to figure down to 8,636,794 produced in box shook, that cost $1.03 per thousand * * * that adds up to a total then of $53.51 per thousand to get the lumber through the box factory, and loaded on the car, and sold."

In the proof of loss (as shown, in detail, at p. 21, Sch. R-2 III, and, in summary, at p. 20, Sch. R-3 II), the insurance companies were given full credit for this sum of $59,240.93 as profits earned from operation of the box shook mill after the fire (R. 218).

On March 22, 1946, appellees made an advance payment to appellant of $250,000.00 (R. 163), the amount paid by each appellee is shown in Column "C" of Plaintiff's Exhibit "C" (R. 48).

On January 4, 1947, appellant filed its proof of loss (Plf's Ex. D, R. 164). On January 27, 1947, appellees delivered to appellant an instrument claiming defects in the proof of loss and requested verified amendments, and on February 6, 1947, appellant replied to that request by an instrument entitled "Reply Affidavit" (R. 165), which is in evidence as plaintiff's Exhibit E.

The printed portion of the policies (Plf's Ex. A) contained the following provisions (R. 24, 25):

> "ASCERTAINMENT OF AMOUNT OF LOSS. This company shall be deemed to have assented to the amount of loss claimed by the insured in his preliminary proof of loss, unless within twenty days after the receipt thereof, or, if verified amendments have been requested, within twenty days after their receipt, or within twenty days after the receipt of an affidavit that the insured is unable to furnish such amendments, the company shall notify the insured in writing of its partial or total disagreement with the amount of loss claimed by him and shall also notify him in writing of the amount of loss, if any, the company admits on each of the different articles or properties set forth in the preliminary proof or amendments thereto.
>
> If the insured and this company fail to agree, in whole or in part, as to the amount of loss within ten days after such notification, this company shall forthwith demand in writing an appraisement of the loss or part of loss as to which there is a disagreement and shall name a competent and disinterested appraiser, and the insured within five days after receipt of such demand and name, shall appoint a competent and disinterested appraiser and notify

the company thereof in writing, and the two so chosen shall before commencing the appraisement, select a competent and disinterested umpire.

The appraisers together shall estimate and appraise the loss or part of loss as to which there is disagreement, stating separately the sound value and damage, and if they fail to agree they shall submit their differences to the umpire, and the award in writing duly verified of any two shall determine the amount or amounts of such loss.

The parties to the appraisment shall pay the appraisers respectively appointed by them and shall bear equally the expense of the appraisement and the charges of the umpire.

If for any reason not attributable to the insured, or to the appraiser appointed by him, an appraisement is not had and completed within ninety days after said preliminary proof of loss is received by this company, the insured is not to be prejudiced by the failure to make an appraisement, and may prove the amount of his loss in an action brought without such appraisement."

On February 10, 1947, appellees sent to appellant a notice advising that they disagreed with the amount of loss claimed in the proof of loss (R. 166). The parties failed to agree, within ten days thereafter, upon the amount of the loss (R. 166). On February 21, 1947, appellees, pursuant to the above-quoted appraisal provisions of the policies, demanded in writing an appraisement of the loss and named Mr. Frank Maloney, of Sacramento, as appraiser (R. 166). Appellant, as required by the appraisal provisions of the policies, named an appraiser—Mr. Anson Herrick, of San Francisco, and advised appellees thereof (R. 166), and the two selected Mr. Lewis Lilly, of San Francisco, as umpire (R. 166).

Appellant requested the appraisers to hold hearings and to give notice of the time and place thereof (R. 290). Pursuant to notice (R. 293), the appraisers held hearings, at San Francisco, on March 26 and 27, 1947 (R. 294).

At the hearings Mr. K. W. Withers and Mr. W. N. Ball, representing appellees (R. 223), presented to the

appraisers a brief entitled "Memorandum to Appraisers" (Deft's Ex. 3, R. 223), pointing out to the appraisers that the proceedings before them were "not a legal procedure nor arbitration," and cautioning them that they were "not authorized to interpret contract or to deal with the legalities of the contract," and that "should there be questions involved as to coverage, extent of liability, or the applications of the terms of the contract, the award as to values and loss should be in such form and detail that either interpretation of the contract or liability could be applied."[9]

On May 2, 1947, the appraisers made their report entitled "Award and Other Findings of the Appraisers" (R. 167).[10]

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[9]The opening paragraph of which reads: "*The conduct of an appraisal under the policies held by the Pickering Lumber Corporation is not a legal procedure nor arbitration. It is a special provision under the policy in which the appraisers are authorized only to determine the amount of loss sustained and the values of the subject of insurance without reference to the question of liability or extent of liability for such items of loss.* There can be no objection to the appraisers being furnished with, having, or obtaining any information or reference which they might wish in their deliberations in determining values, and loss sustained, *but they are not authorized to interpret contract or to deal with the legalities of the contract. Should there be questions involved as to coverage, extent of liability, or the applications of the terms of the contract, the award as to values and loss should be in such form and detail that either interpretation of the coverage or liability could be applied.* * * *." The next to the concluding paragraph said: "*Should it be found that a legal question of coverage or extent of liability is involved, the appraisers award should be sufficiently detailed so that either legal construction can be applied. As previously stated, the appraisal vests authority only to deal with matters of value and loss.*" (Italics supplied.)

[10]The award appears at P. 168 of the Record and, omitting caption and signatures, is as follows:

> "The undersigned, Frank Maloney and Anson Herrick, duly appointed as appraisers, respectively, by Fire Companies' Adjustment Bureau, Inc., on behalf of the insurers, and the insured, and the undersigned Lewis Lilly, duly selected by the said appraisers as umpire, all under the provisions of the California Standard Form Fire Insurance Policy relating to the ascertainment of amount of loss, after consideration of all facts and arguments presented at a hearing held in San Francisco on March 26 and 27, 1947; the arguments presented in an undated brief filed on behalf of the insured by its counsel; of arguments contained in an undated memorandum and in a letter dated April 4, 1947, of the insurers; and of other information and data properly obtained by the appraisers, find as follows:
> (1) The net profits prevented and fixed charges and continuing expenses during the period July 8, 1945, to April 7,

Application of the contribution clause of the policies (Paragraph 4 of the mimeographed attachment to the policies—R. 33) to the figures in the report of the appraisers produced an aggregate amount payable to appellant of $491,378.41 (R. 171), and the portion thereof allocable to each of appellees, less the advance payment, is shown in column "B" of Plaintiff's Exhibit "C" (R. 48). These amounts were tendered to appellant, which tenders appellant refused to accept, saying it intended to contest the validity of the award (R. 171).

Appellees then commenced this action on June 13, 1947, in the District Court of the United States for the Northern District of California, Southern Division, as heretofore stated.

By agreement of the parties at the trial, the depositions of the appraisers, Mr. Herrick and Mr. Maloney, and of the umpire, Mr. Lilly, taken in the case, were received in evidence in lieu of producing them as witnesses (R. 297, 298).

The figures presented to the appraisers by appellees were the same as contained in appellant's proof of loss[11]

1946, reduced by profits realized and fixed charges and continuing expenses recovered by partial operation following the fire amounted to *Five Hundred and Eighty-One Thousand Dollars ($581,000).*

(2) The net profits prevented and charges and expenses which would normally have been earned during the period of twelve months immediately following the fire amounted to *One Million and Thirty Thousand Dollars ($1,030,000)*

(3) The expenses incurred by the insured, other than those constituting costs of partial operations, for the purpose of reducing the loss under this policy amounted to *Seventeen Hundred and Sixty Dollars ($1,760),* which amount does not exceed the amount in which the loss was so reduced.

In reaching such findings the appraisers or the umpire did not find it necessary to resolve any legal question of coverage or extent of liability."

[11]At R. 500, Mr. Herrick testified that the appellees' accountant, Mr. Frank Baker, "used the data shown by the proof of loss, and with certain modifications of factors that entered into it, and by the adoption of different principles of allocation, came to a different result." At R. 501, Mr. Herrick testified: "I have no recollection that he disputed any of the amounts as shown by the proof of loss * * * with the possible exception—you might call it a dispute—the amount considered as the cost of depletion. * * * And that I don't think should really be called a dispute. It was merely the adoption of a different figure on a different theory."

Mr. Maloney testified, at R. 601: "Q: I will ask you if you remem-

and it was agreed by all the parties that these figures were the only figures necessary for the appraisers to consider[12].

As to the matters of excess logging costs after the fire, expense of extending the decking yard and the logging railroad tracks therein, and of decking logs after the fire, the appraisers accepted the figure of $42,797.04 shown in the proof of loss as the extra logging costs after the fire[13]. They also accepted the figure of $12,492.35 shown in the proof of loss as the extra expense in decking

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ber, there was no actual difference in the actual figures taken from the books in either those presented by Pickering in its proof of loss or in Baker's, is that right? It was a difference in handling? A. Just the difference in setup primarily. Q. That is, they came to different conclusions? A. Yes. Q. But there was no dispute about the accuracy of the figures they used? They used the same figures, did they not? A. I feel sure that they did. Q. Was that the reason that you did not believe it necessary to go and examine Pickering's books? A. That's right."

[12]Mr. Herrick testified on cross-examination, at R. 562, 563: "Q. Is it your recollection that it was agreed to by both parties that the data which was in the posession of the appraisers in the form of the original claim and the various analyses by accountants on both sides, the testimony and other information given, was all that was necessary for the appraisers to consider in reaching their award? A. Right."

[13]Mr. Herrick testified, at R. 532, 533: "Q. The excessive logging costs, $42,797.04, is found in the proof of claim, isn't it? A. That's right. * * * Q. And the excessive logging costs were figures that appeared on page 22 of the proof of claim, were they not? * * * A. Yes, you are right. Q. Did the appraisers attempt to find out whether there was anything wrong in the figures used for making up that schedule, or was that accepted? A. I think the appraisers accepted the figures as shown by the—on page 24, which was the basis for the computation of the claim on page 22. Q. On page 22. That is more accurate. They accepted the figures on page 24 which resulted in the calculation on page 22? A. That's right." (Page 24 of the proof of loss shows the detail of the extra logging costs and page 22 of the proof of loss shows the summary calculation of those extra logging costs.)

Mr. Maloney testified, at R. 608, 609: "Q. You don't remember whether or not they accepted the figures as to the actual amount of excess logging costs? A. Of what? Q. Of excess logging costs? I am not talking about whether they accepted the idea that it should be allowed, but whether they thought the books properly recorded the amount of excess logging costs? A. To the best of my knowledge, neither Mr. Lilly nor Mr. Herrick, who were going into Pickering's books, ever questioned the books at any time, as to their accuracy." (Then Mr. Maloney added in longhand, just before the deposition was filed at the trial, the folowing: "This does not mean that I accept this figure of excess logging cost used by Pickering. I did not.") "Q. You didn't go into that feature of it? A. I couldn't. Q. What? A. I would get lost. Q. I say you did not? A. No. Q. You had to rely upon them for that? A. I definitely relied on Mr. Herrick and Mr. Lilly. Q. As to the accuracy of the figures? A. That's right."

the logs after the fire[14], and they accepted the figure of $36,149.95 shown in the proof of loss as the amount of decrease in value of logs in the nine months loss period after the fire[15], but they did not agree as to the allowability of these three items[16] because they did not accept appellant's theory that those items were insured by the policies[17]. The insurance companies denied all liability for the excessive logging costs[18], and there was a dispute between the appraisers as to whether these items should be allowed[19]. The appraisers were of the view that inasmuch as appellant still had the logs on hand it should absorb the extra logging costs after the fire, and, by milling the logs, would, in the long run, recover its full cost

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[14]Mr. Herrick testified, at R. 536: "Q. Well, now, the log decking, $12,492.35, as I understand it, that is the figure that Pickering claimed? A. That's right. Q. And that is the figure shown by the figures that they had in their proof of claim? A. That's right. Q. Did the appraisers question the accuracy of the figures as to how much expense there was for log decking? A. No."

[15]Mr. Herrick testified, at R. 533: "Q. * * * was there any evidence introduced at all as to the amount of that log stain that would have occurred within nine months? A. Very complete evidence on the part of Mr. Moffett." And, at R. 535, 536, Mr. Herrick continued: "Q. Did the appraisers come to the conclusion that the testimony was wrong, or was that what the trouble was? A. No. Q. That was not the trouble? A. That was not the trouble. * * * The question of the accuracy of the computation of those figures was not raised."

[16]Mr. Herrick testified, R. 541: "Q. That was the part you couldn't agree on, as to whether it was— A. The two things: The excessive logging costs and the stain. Q. And the decking? A. And the decking. Q. Three things, really? A. Yes."

[17]Mr. Maloney testified, at R. 608: "Q. But you did not accept the theory that it ought to be allowed for the reasons that you have mentioned? A. That's right."
Mr. Herrick testified, at R. 536: "Q. * * * the accuracy of the figures that I have just been talkng about was not the thing that caused discussion for days? A. No. Q. What was it that was the cause of the discussion? A. The question as to the allowability of it at all."

[18]Mr. Herrick testified, at R. 532: "Q. The excessive logging costs, $42,979.04, is found in the proof of claim, isn't it? A. That's right. Q. And the insurance companies denied any liability for it at all * * *? A. They denied any liability at all."

[19]Mr. Herrick testified, at R. 537: "Q. Was there a dispute between the appraisers as to whether these things should be allowed at all or not? A. Yes."

for them[20], and also took the position that the depreciation on the logs in the nine months loss period after the fire was "deterioration" and not depreciation within the meaning of that term as used in, and insured by, the policies[21], and there was much discussion between the appraisers upon "the question as to the allowability of it (these claims) at all." (R. 70 of Herrick's Deposition.) And finally the appraisers, without making any kind of computation and without finding the amount of these items[22] and without submitting the matters to the umpire[23], agreed upon an arbitrary lump sum compromise allowance of $25,000.00 for these items aggregating $91,439.34[24].

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[20]Mr. Herrick testified, at R. 538, 539: "Q. Was it your idea that a part of the cost after the fire went into logging, and they still had logs on the way, and for that reason they should absorb this cost? Was that the idea? A. Why, that is fundamental, Judge. Q. Well, am I right? A. Certainly, you are right on that."

Mr. Maloney testified, at R. 604: "Q. Do you remember what was done with that; whether it was allowed or not? A. No, not—as a single individual item, it was not. Q. Do you remember why it was not? A. There was a great deal of discussion in regard to the excessive logging costs; and the values to them; and that there should be some recovery, but they would be benefitted by it in the longer run."

[21]Mr. Herrick testified, at R. 540: "A. The so-called log stain was designated in the claim as depreciation; and if you will pardon me for saying so, Judge, that was not true. It was not a depreciation as the term is understood. It was deterioration, which was not a continuing expense. If allowable, it would be what we call expediting expense. And if allowable as an expediting expense, would not have been controlling in my opinion under the co-insurance provision."

[22]Mr. Herrick testified, R. 537: "Q. * * * Well, was the $25,000.00 a figure that was arrived at by any kind of computation? A. No."

[23]The umpire, Mr. Lilly, testified, at R. 579, 580: "Q. * * * Those were the three items that you arrived at the twenty-five thousand, is that right? A. I imagine those were the items included? Q. Were you in on that decision? A. I don't think that I was—that there was a final joining of issue. I think that was agreed upon by the—I am speaking from memory—I think the appraisers agreed on that figure; and it was agreeable to me." And, at R. 580, he testified: "Q. You think they worked that out between themselves? A. To the best of my knowledge, that was it, yes."

[24]Mr. Herrick testified, at R. 537: Q. *Was it arrived at by agreement?* A. *Yes.* Q. *Was there a dispute between the appraisers as to whether these things should be allowed at all or not?* A. *Yes.* Q. *Is that what resulted in the agreement?* A. *Yes.* Q. *Was it a compromise?* A. *You might call it—, Yes, I think you would call it a compromise.*"

Mr. Maloney, referring to a sheet containing these items, with a bracket around them, and $25,000.00 written at the side in Mr. Herrick's handwriting, testified, at R. 605: "That means that we allowed $25,000.00 for the first 4 items on the sheet * * *." (Italics supplied.)

As to the costing of appellant's box lumber into the box shook mill in partial operations after the fire, the appraisers used OPA ceiling prices[25], because "it was the price that the law prescribed"[26]. Mr. Herrick thought that the box lumber, being at the box mill for manufacture into shook, should carry a higher than OPA price for box lumber, but Mr. Maloney took the opposite view, and the matter was submitted to the umpire, Mr. Lilly, who agreed with Mr. Maloney on the use of OPA prices[27].

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[25]Mr. Herrick testified, at R. 545: "A. The profit for the box factory was arrived at by taking *the constructed market price for the lumber* that was converted into shook, and the expenses of operating the box factory, and deducting the aggregate from the proceeds of the shipments. * * *" And, at R. 545, he testified: "A. *The constructed market price was the so-called legal price at which the lumber could have been sold*—that is, the lumber which was converted into—through the box factory—*could have been sold as lumber*, plus the most advantageous freight differential. Q. Which, by the way, was a part of the OPA price, wasn't it? A. No, the OPA prices were on a basing point of Susanville; and there was added to the OPA the freight from Susanville to the point of destination, less the actual freight from Standard to the point of destination. Q. * * * if they had sold under OPA, they would have been permitted to sell it that way, wouldn't they? A. Yes. Q. In other words, the OPA prices being based at Susanville, if you could sell at places where the freight was less than that, you actually could make that freight differential by selling under the OPA? A. Yes."

Mr. Maloney testified, at R. 612: "Q. *Well, do you know how you arrived at it?* A. *Oh, yes, we used the OPA ceiling price, plus the freight differential.* Q. So the OPA ceiling price allowed the freight differential, didn't it? A. No, we used the OPA ceiling price plus the freight differential. Q. But the OPA regulations provided for that, didn't they? A. Oh, sure they did. Q. *So you were actually using OPA ceiling prices for that?* A. *That's right.* But we added a very favorable freight differential." (Italics supplied.)

[26]Mr. Maloney testified, at R. 613: "Q. *Then why did you use the OPA?* A. *Standard price. The known price. It was the price that the law prescribed*, and Mr. Herrick and Mr. Lilly stated that was the proper accounting practice." He further testified, R. 614: "Q. *It was what had been established by the government?* A. *Right. That is what we worked our price from.* Q. *Was that the only consideration?* A. *That's right, as far as the price base was concerned.* Q. *There wasn't any other?* A. *Not to my knowledge.*"

Mr. Herrick testified, at R. 548: "Q. * * * Then explain to me why you used OPA ceiling prices? A. *Because those were the only prices of which we had knowledge at which the lumber could have been sold as lumber.*" (Italics supplied.)

[27]Mr. Lilly testified, at R. 583: "I think there were two views there, as I recall; Mr. Herrick had one view, and asserted one view to the effect that he thought the material being there should carry a higher price than OPA prices; *and Mr. Maloney said— * * * I think took the opposite viewpoint, that the OPA price was the price to be used.* Q. *Do you recall, in regard to that, making the decision?* A. *I think I acquiesced in the OPA price plus the agreed upon freight differential. I* think that freight differential was Fresno and Merced or Fresno and Modesto; I can't tell which." (Italics supplied.)

The appraisers assumed a theoretical sale, under OPA prices, of one-half the box lumber for Merced, California, delivery, and the other one-half for Fresno, California, delivery, and averaged the freight salvage from the basing point of Susanville to the assumed delivery points of Merced and Fresno, and added that averaged freight salvage to the basic OPA price[28]. The appraisers recognized that the OPA ceiling prices on box lumber were less than appellant's cost for producing the lumber[29], and they recognized that appellant could not have purchased the box lumber at OPA ceiling prices[30] and they did not use those prices on the theory that appellant could have purchased the lumber at that cost, but upon the theory that appellant could not lawfully have sold that lumber on the market, as lumber, for a higher price[31].

We now turn to the action of the appraisers in adding to annual values depreciation on the destroyed sawmill for the year after its destruction by fire.

Paragraph 4 of the mimeographed attachment to the policies (Plf's Ex. B) provides (R. 33):

> "4. 'CONTRIBUTION CLAUSE'—It is expressly stipulated and made a condition of this contract that, in the event of loss, this company shall be liable for

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[28]Mr. Herrick testified, at R. 546: "A. *The constructed market price* which was used *was based on the sale—I think for half the quantity at Modesto for Merced delivery,* at which point it would have given the company the greatest return; *and the other half at Fresno,* which gave it a little less return, and it was averaged out." (Italics supplied.)

[29]Mr. Herrick testified, at R. 546, 547: "A. * * * it was completely recognized that the OPA prices on the quality and the grade of lumber that went through the box factory was less than the average cost of all lumber produced."

[30]Mr. Herrick testified, at R. 547: "Q. Do you remember that there was evidence to the effect that Pickering couldn't have bought the lumber that went to the box factory at the OPA ceiling prices? A. Yes. Q. Did the appraisers question that testimony? A. No, not only did the appraisers not question it, but it was within their general knowledge. Q. They knew that was a fact? A. Yes."

[31]Mr. Herrick testified, at R. 547: "Q. Then you didn't take OPA prices on the theory that Pickering could have actually paid that? A. Yes, that is right. Q. You only considered it in the light that they would not have been able to sell it at any higher price? A. That's right. Q. If they had sold, that would have had to be out on the market? A. That's right."

> no greater proportion thereof than the amount hereby insured bears to seventy five per cent (75%) of the total of the net profits (ITEM I) and charges and expenses (as specified in ITEM II), which would normally have been earned during the period of twelve (12) months immediately following the fire."

In computing profits prevented, appellant in its proof of loss deducted, both in the nine months period column and in the one year period column, the amount of depreciation that had occurred on the (burned) sawmill in the agreed test year—the year preceding the fire[32] (R. 418).

The appraisers added to annual values in the year after the fire the sum of $15,042.00 as depreciation on the destroyed sawmill in the year after its destruction by fire[33]. They also originally added three-fourths of that amount to the values for nine months after the fire, but later took that sum out[34].

Further detailed facts, as material, will be stated in the argument.

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[32]See footnote No. 2 on page 8 hereof.

[33]Mr. Herrick testified, at R. 517, 518: "Q. How much more? A. $15,095.00. Q. Can you account for that? A. With the exception of $53.00, it constituted the depreciation on the destroyed property which had been omitted in part from the claim." He further testified, at R. 518: "Q. In other words, in fixing the amount of fixed charges and continuing expenses for the entire year, you added depreciation on the property that had been destroyed? A. That's right."

[34]Mr. Herrick testified, at R. 518: "Q. Did you add any part of that into the fixed charges and continuing costs for the nine months? A. Yes. Q. Is that the one that you say later was eliminated? A. Can this be off the record? A. Yes. * * * Q. Look at page 4, item 6, 'Elimination of item included in 4.' What is that? A. The item of $11,178.00 mentioned as a part of item 4 on page 4 of the statement represents the inclusion within fixed charges and continuing expenses of the proportionate part of this depreciation applicable to the loss period, which was subsequently taken back as a recovery item." And, at R. 520, Mr. Herrick testified: "Q. But that while you put it in, you took it out again? You ultimately didn't allow it in the schedule on the ground that it didn't occur? A. That is correct. Q. In other words, because the policy says 'would normally have been earned,' in making the twelve months calculation you did not do it on the same basis that you did on the nine months? A. That's correct. Q. One was what it would have been, and the other was what it actually was? A. That is correct."

SPECIFICATION OF ERRORS RELIED UPON.

I. The court erred in holding, contrary to all the evidence, that the provision for appraisement in the policies authorized, and that the parties contemplated and intended, that the appraisers should interpret and construe the policies and decide such and other questions of law, with finality.

II. The court erred in holding that the fact that the appraisers "considered" the excess logging costs, the decking expense and the log depreciation, aggregating $91,439.34, and made a lump sum compromise allowance thereon of $25,000.00, constituted a proper discharge of their duties under the submission.

III. The court erred in holding that the appraisers did not exceed, but properly discharged, the submission in rejecting appellant's actual cost, and in substituting OPA ceiling prices, for the lumber put through the box shook mill after the fire.

IV. The court erred, as a matter of law, in holding that the appraisers properly added to annual values unreal depreciation on the destroyed sawmill for the year following its destruction by fire.

ARGUMENT.

I.

The court erred in holding, contrary to all the evidence, that the provisions for appraisement in the policies authorized, and that the parties contemplated and intended, that the appraisers should interpret and construe the policies and decide such and other questions of law, with finality.

The district judge said in his opinion:

> "* * * if the questions of accountancy or law were implicit in or incidental to such determination it was the clear intent of the provisions for reference in said policies that the referees should make such determinations, whether they were appraisers or arbitrators" (P. 4 of Op.). And that "The referees were required to decide upon the amount *due the defendant under the policies*" (P. 10 of Op.). And, "Furthermore, as heretofore stated the very nature of the questions to be submitted to the referees *by the terms of the policies* indicated that it was contemplated by and the intent of the parties that the referees *should pass upon any subject that was implicit in or incidental to such determination,* including questions of accountancy or law, whether they be called appraisers or arbitrators. Accordingly *if in determining these questions they were required to construe the policies or settle questions of law they were acting within the scope of the submission*" (P. 14 of Op.). (Italics supplied.)

It is expressly found, in Finding XVIII (R. 136), that:

> "It is true that the referees undertook to construe certain provisions of said policies; in each instance where they did so, however, it was necessary that they do so in order to arrive at an award, and such construction of the policies by the referees was implicit in and incidental to the determination of the questions submitted to them for decision and award; it was the clear intent of said policies and it was contemplated by and was the intent of plaintiffs

> and defendant that the referees should pass upon and determine with finality any question of the construction of the policies implicit in or incidental to the making of an award; * * *."

These holdings set forth the basic and vital error committed by the court.

The only agreement for appraisal that existed between the parties was that contained in the printed portion of the policies (Plf's Ex. A), which is precisely in the form designed, for policies of direct fire insurance—not use and occupancy insurance—, by the California fire insurance policy form statute (Secs. 2070, 2071, California Ins. Code, 1937). That agreement provides for "an appraisement of the loss" by an "appraiser" to be named by the insurers and an "appraiser" to be named by the insured and an "umpire" to be named by them, and the "appraisers" were to "estimate and appraise the loss" and state "separately the sound value and damage," and if they failed to agree they were to "submit their differences to the umpire."

Those appraisal provisions were at once the source and the limit of the appraisers' authority, *Continental Ins. Co.* v. *Garrett,* 125 F. 589, 590 (6th Cir.)[35]. The question of what matters the appraisers were authorized to consider and determine depends entirely upon the intention of the parties, to be ascertained by the same tests that are applied to contracts generally, *Marchant* v. *Mead-Morrison Mfg. Co.,* 252 N. Y. 284, 169 N. E.

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[35]In this leading case Judge, later Justice, Lurton said on this point:

> "The agreement under which the appraisers were selected *was at once the source and limit of their authority,* and the award, to be binding, must, in substance and form, conform to the submission. The submission required the appraisers to determine two things, and two things only, for the submission was only for the purpose of determining the amount of loss, and no other defense open to the insurer was submitted." (Italics supplied.)

386, 391[36]; and the empowerment of third parties to interpret contracts and to resolve such and other questions of law, with finality, thus ousting the normal functions of the courts, requires an agreement so saying in clear and unmistakable terms, and such powers never can be implied. *U. S.* v. *Moorman,* 338 U. S. 457, 462, 70 S. Ct. 288[37], *Mercantile Trust Co.* v. *Hensey,* 205 U. S. 298, 309, 27 S. Ct. 535[38], *Continental Milling & Feed Co.* v. *Doughnut Corporation of America.*, 186 Md. 669, 48 A. (2d) 447, 450[39], *Fernandez & Hnos* v. *Rickert Rice Mills,* 119 F. (2d) 809, 815 (1st Cir.)[40], and *Jacob* v. *Weisser,* 207 Pa. 484, 56 A. 1065, 1067[41].

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[36]In this leading case, Judge, later Justice, Cardozo said on this point.

> *"The question is one of intention, to be ascertained by the same tests that are applied to contracts generally. * * * No one is under a duty to resort to these conventional tribunals,* however helpful their processes, *except to the extent that he has signified his willingness.* Our own favor or disfavor of the cause of arbitration is not to count as a factor in the appraisal of the thoughts of others." (Italics supplied.)

[37]Where the court, in considering a dispute under a government war contract that expressly gave to the Secretary of War the power to determine "all claims by a contractor," said:

> "It is true that *the intention of the parties* to submit their contractual disputes to final determination outside the courts *should be made manifest by plain language.*" (Italics supplied.)

[38]Where the court said on this Point: "To make such a certificate conclusive *requires plain language in the contract. It is not to be implied.*" (Italics supplied.)

[39]In this case the court, after quoting Judge Cardozo's language in the Marchant case, *supra*, saying that "the question is one of intention," said:

> "Sound policy demands that the terms of an arbitration *must not be strained to discover power to pass upon matters in dispute, but the terms must be clear and unmistakable* to oust the jurisdiction of the court, for trial by jury can not be taken away in any case *merely by implication.*" (Italics supplied.)

[40]In this case the court said: "A party is never required to submit to arbitration any question which he has not agreed so to submit, and contracts providing for arbitration *will be carefully construed in order not to force a party to submit to arbitration a question which he did not intend to be submitted.*" (Italics supplied.)

[41]Where the court said: "But, under any circumstances, before the decision of an arbitrator can be final and conclusive, it must appear, as was said in *Chandley Bros.* v. *Cambridge Springs,* 200 Pa. 230, 49 Atl. 772, *that power to pass upon the subject-matter is clearly given to him. 'The terms of the agreement are not to be strained to discover it. They must be clear and unmistakable to oust the jurisdiction of the courts,* for trial by jury *can not be taken away by implication, merely, in any case.'*" (Italics supplied.)

Actually, there is no basis under the policies, and the law, and not a word of evidence in the record, to support the statements that the appraisers were, and were intended by the parties to be, empowered to interpret and construe the policies and to decide "the amount due the defendant under the policies," and to decide questions of law, with finality.

No provision in the appraisal clause in the policies says—certainly not in any "plain language" or "clear and unmistakable terms"—that the appraisers shall be authorized to interpret the policies or to find the amount due under them or to determine any other questions of law. The district court here did not find or state to the contrary, but, instead, he held that the power to interpret the policies and to determine the amount due thereon and to decide such and other questions of law was "implicit in or incidental to" the submission. He thus implied those powers. This was error, and contrary to the law as declared in the cases above cited.

As to the statement of the court that the appraisers were authorized to interpret the policies, there is a further short and complete answer. The statement is contrary to the actual provisions of the policies themselves. The printed portion of the policies contained the following paragraph:

> "NON-WAIVER BY APPRAISAL OR EXAMINATION. This company shall not be held to have waived any provision or condition of this policy or any forfeiture thereof, by assenting to the amount of the loss or damage or by any requirement, act, or proceeding on its part *relating to the appraisal or to any examination herein provided for*" (R. 27). (Italics supplied.)

The obvious purpose of this paragraph in the policies was expressly to reserve from any submission to appraisers any power to construe or interpret the policies. The Supreme Court of California, in the case of *Stockton Combined Harvester & Agricultural Works* v. *Glens Falls Ins. Co.,* 98 Cal. 557, 33 P. 633, 634, where this very para-

graph was before it, observed that such was its purpose and effect. This provision is mutual and inures to the protection of the insured, the same as to the insurers, because, as stated by Judge Lurton in *Continental Ins. Co.* v. *Garrett,* 125 F. 589, 591, "An award ought not to be valid or invalid at the option of one only of the parties."

As to the intention of the parties,—and Judge Cardozo in the Marchant case, *supra,* said that "the question is one of intention,"—we point out that the insurance companies, by the Withers and Ball memorandum to the appraisers, expressly told the appraisers that:

> "The conduct of an appraisal under the policies held by Pickering Lumber Corporation *is not a legal procedure nor arbitration.* It is a special proceeding under the policies in which *the appraisers are authorized only to determine the amount of loss sustained and the value of the subject of insurance without reference to the question of liability or extent of liability for such items of loss. * * * They are not authorized to interpret contract or to deal with the legalities of the contract. Should there be questions involved as to coverage, extent of liability, or the applications of the terms of the contract, the award should be in such form and detail that either interpretation of the coverage or liability could be applied"* (Page 1 of Deft's Ex. 3). (Italics supplied.)

Furthermore, the appraisers themselves so understood, for they were at pains to say, in the last paragraph of their report, that:

> "In reaching such findings the appraisers or umpire did not find it necessary to resolve any legal question of coverage or extent of liability" (R. 170).

Thus it is made clear that the only agreement between the parties respecting appraisal was that contained in the policies themselves, and that the appraisal clause of the policies did not—certainly not by any "plain language" or by any "clear and unmistakable terms"—

authorize the appraisers to interpret the policies or to decide such and other questions of law, but, to the contrary, the policies contained a clause expressly reserving those powers from the appraisers, and that appellees, in writing, definitely told the appraisers that they did not intend that the appraisers should interpret the policies or decide questions of law, and that the appraisers so understood, and the District Court, believing that such questions were "implicit in or incidental to" the submission, implied the power in the appraisers to interpret the contract, decide questions of law, determine the amount due under the policies and resolve the whole controversy, which was clear and vital error.

Further, it is obvious that the California legislature, in enacting the fire insurance policy form statute which contains this appraisal clause, did not intend nor contemplate that the "appraisers," for which it provided, should be "arbitrators" with power to construe and interpret the policies, and to decide such and other questions of law with finality. To demonstrate this, we again point out that the appraisal clause is contained in the printed part of the policies, which is precisely in the form designed by the California fire insurance policy form statute (Secs. 2070, 2071, California Ins. Code, 1937) for inclusion in policies of direct fire insurance. We next point out that at least since the decision by the Supreme Court of California in the case of *California Annual Conference of M. E. Church* v. *Seitz,* 74 Cal. 287, 15 P. 839, in the year 1887, it has been the settled law in California that a contract by which the value of property or the amount of loss or damage is, for the purpose of the contract, to be fixed by third persons, is a mere appraisement and not a submission to arbitration[42]. And

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[42]In that case, at p. 841 of 15 P.. the court said:

"Accordingly in the well-considered case of *Scott* v. *Avery,* 5 H. L. Cas. 811, it was held that a condition in a policy of insurance in a mutual company, that the loss should be 'ascertained and settled by the committee,' was not a submission to arbitration in its proper sense, but was a condition precedent to the right of action. Similar decisions have been made in this and other states. *Holmes* v. *Richet,* 56 Cal. 307; *Loup* v. *R. R. Co.,* 63 Cal. 103; *Cox* v. *McLaughlin,* Id. 207; *Old Saucelito Co.*

the Supreme Court of California, in the case of *Bewick* v. *Mecham,* 26 Cal. (2d) 92, 156 P. (2d) 757, decided in 1945, said, on this point, that the Seitz case, *supra,* "may be considered as establishing this doctrine in this state" and, in quoting from *Brink* v. *New Amsterdam Fire Ins. Co.,* 28 N. Y. Super. Ct. 104, said, further, " 'There is scarcely a day in which, in commercial transactions, the valuation of property or estimate of damages is not entrusted to third parties, and no one has yet dreamed of looking upon them as arbitrators * * *.' " Such is the long-standing and settled law of California.

Since 1851, and therefore long prior to the decision by the California Supreme Court in the Seitz case, California has had an arbitration statute (now Secs. 1280, et seq., of The Code of Civil Procedure of California), and for a long time prior to March 18, 1909, it also had a statute (now Sec. 16, The Code of Civil Procedure of California —also Sec. 13, The Civil Code of the State of California) saying:

> "* * * technical words and phrases and such others as have acquired a peculiar and appropriate meaning in law, or are defined in the succeeding section, are to be construed according to such peculiar and appropriate meaning or definition."

In the light of this background, the California Legislature, on March 18, 1908, enacted the California standard

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v. *Commercial Co.,* 66 Cal. 253, 5 Pac. Rep. 232; *Adams* v. *Ins. Co.,* 70 Cal. 198, 11 Pac. Rep. 627; *Carroll* v. *Ins. Co.,* 13 Pac. Rep. 863; *Canal Co.* v. *Coal Co.,* 50 N. Y. 250; *Hudson* v. *McCartney,* 33 Wis. 344; *Haley* v. *Bellamy,* 137 Mass. 359; *Flint* v. *Pearce,* 11 R. I. 577; *Gauche* v. *Ins. Co.,* 10 Fed. Rep. 355; *Fox* v. *R. R. Co.,* 3 Wall, Jr. 245. *These cases hold that a contract by which the value of property or the amount of damage is, for the purpose of the contract, to be fixed by third persons, is not a submission to arbitration,* and therefore to enforce it does not trench upon the jurisdiction of the courts. Now, if this is so, if such a proceeding is not analogous to the investigation by a court of a controversy between the parties, why need it be conducted according to the rules which govern courts in their investigations? We think that it need not; *that the proceeding is a mere appraisement or valuation, which, although binding upon the parties, is not the submission of a controversy to arbitration, and is therefore not subject to the rules which govern arbitrations. And to this effect are the best-considered cases.*" (Italics supplied.)

fire insurance policy form statute (now Secs. 2070, 2071, California Insurance Code, 1937) requiring direct fire insurance policies insuring California property to be in the form of the printed portion of the policies here, and thus to contain the appraisal clause here involved.

It must be presumed that the California legislators knew, when they enacted this policy form statute, that the Supreme Court of California had uniformly held that third parties appointed to determine the value of property, or the amount of loss or damage to property, were appraisers and not arbitrators, and it must be assumed, too, that they knew of their own statute saying that words of technical legal import should be understood in their technical legal sense.

Yet—and this is most significant—the California Legislature, in prescribing the appraisal clause in the policy form statute, did not once use the technical word "arbitration," but, instead, used the technical words "appraisement" and "appraisers," thus providing, as clearly as words could, for an "appraisement," as that term has been settled by the Supreme Court of California in the Seitz case and other cases, and not for an "arbitration" of all controversies under the California arbitration statute.

This identical situation was dealt with by the Supreme Court of Missouri in the case of *Dworkin* v. *Caledonian Ins. Co.,* 285 Mo. 342, 226 S. W. 846, where it was held that it must be presumed that the Legislature, in passing the policy form statute, understood the distinction in meaning beween the technical words "appraisers" and "arbitrators," and provided for an "appraisement," not an "arbitration," with that distinction in mind.[43]

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[43]In that case the court said, p. 850 of 226 S. W.:

"But the principal rule of interpretation to be applied to the act in question (the arbitration statute) is prescribed by our statutes, to-wit:

"'Technical words and phrases having a peculiar and appropriate meaning in law shall be understood according to their legal import.'

"That is to say, in getting at the intention of the legislators in enacting a law which contains a technical expression, we must presume the expression was used in its technical sense,

This makes clear that the California Legislature, in enacting its policy form statute, which contains the appraisal clause here in question, did not contemplate nor intend that the appraisers they provided for should have the power of arbitrators, and makes clear, too, that the parties here, in the use of that appraisal clause, did not so intend.

In addition to the procedural differences between appraisement and arbitration (such as the legal requirements that arbitrators—but not appraisers—must hold formal hearings on notice, swear the witnesses and take testimony, and decide the matter solely on that testimony), whether it be statutory or common law arbitration, there is the fundamental distinction that arbitrators, in the technical sense of the term, are private judges and proceedings before them are a substitute for proceedings in court, and they have power to conclude, even mistakenly, both the law and the facts by their award,[44] whereas, apprais-

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unless there is something in the context to indicate that it was not. * * * If the word 'arbitration' was used in the statute in its legal sense, and as a term of art, then beyond a doubt the stipulation for an 'appraisement' was not one for an arbitration. * * *

"As the difference between an agreement for an arbitration and an agreement for an appraisement had been recognized by the courts of this state many years prior to the enactment of the section in question, we must presume the distinction was known to the members of the Legislature and that they passed the law with it in mind."

[44]In *Burchell* v. *Marsh*, 58 U. S. 344, 17 How. 344, 349, it is said:

"*Arbitrators are judges* chosen by the parties to decide the matter submitted to them." (Italics supplied.)

In *Empire Plexiglass Corp.* v. *Levitt Corp.*, 192 N. Y. Misc. 251, 77 N. Y. Supp. (2d) 85, it is said:

"*Arbitrators are judges in fact, though not in name.*" (Italics supplied.)

In *California Annual Conf. M. E. Church* v. *Seitz*, 74 Cal. 287, 15 P. 839, 840, it is said:

"An arbitration is a substitute for proceedings in court."

And at 842:

"An award is the *judgment of a tribunal* selected by the parties to determine matters mutually at variance between them —*not merely to appraise and settle the price of property* * * *." (Italics supplied.)

In *Thompson* v. *Newman*, 36 Cal. App. 248, 171 P. 982, 983, it is said:

"An arbitration presupposes a controversy * * * *to be tried and decided*, and the *arbitrators proceed in a judicial way*, * * *.

ers, in the technical sense of the term, have no judicial powers, but are mere valuers.[45]

But the District Court in this case relied upon, and cited in support of his conclusion, that these appraisers had power to interpret the policies and decide questions of law, with finality, the cases of *Continental Ins. Co.* v. *Titcomb,* 7 F. (2d) 833 (8th Cir.); *Chandos* v. *American Fire Ins. Co.,* 84 Wis. 184, 54 N. W. 390; and *Patriotic Order Sons of America* v. *Hartford Fire Ins. Co.,* 305 Pa. 107, 157 A. 259.

In the *Titcomb* case the court was dealing with a case that arose in, and under the fire insurance policy form statute of, Minnesota, and, of course, even at that time and before *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64, 58 S. Ct. 817, the federal courts were bound by the state courts' construction of the statutory laws of the state. As pointed out in the opinion in the *Titcomb* case, "Minnesota had uniformly held that these proceedings to ascertain the amount of damages under standard policies constitute a common law arbitration." (Citing *McQuaid Market House Co.* v. *Home Ins. Co.,* 147 Minn. 254, 180 N. W. 97; and *American Central Ins. Co.* v. *District Court,* 125 Minn. 374, 147 N. W. 242.) Such a proceeding being made "a common law arbitration" in Minnesota, the federal court was required to hold that "the award,

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Their investigation is *in the nature of a judicial inquiry.*" (Italics supplied.)

In *St. Paul Fire & M. Ins. Co.* v. *Eldracher,* 33 F. (2d) 675, 678, (8th Cir.), it is said:

"Arbitrators are said to act *both as court and jury, determining the right of a controversy as well as the quantum of relief.*" (Italics supplied.)

[45]In *Zallee* v. *LaClede Mutual Fire & M. Ins. Co.,* 44 Mo. 530, 532, it is said an appraisal is "something less than an arbitration."

In *Littlehead* v. *Sheppard,* 123 Okla. 29, 251 P. 60, 62, it is said: "Appraisement means 'a valuation of, or an estimation of, the value of property.'"

In *Tax Commission of Ohio* v. *Clark,* 20 Ohio App. 166, 151 N. E. 780, 781, it is said: "To 'appraise' means to value property at what it is worth."

In *American Fire Ins. Co.* v. *Bell,* 33 Tex. Civ. App. 11, 75 S. W. 319, 320, it is said: "They (appraisers) have no judicial powers * * *."

In *Phoenix Ins. Co.* v. *Everfresh Food Co.,* 294 F. 51, 55 (8th Cir.), it is said appraisers are "not called on to discharge *judicial or quasi-judicial functions* as in arbitration, but to render a duty *ministerial in character.*" (Italics supplied.)

being *governed by the rules applicable to a common law arbitration,* * * * is not open to attack, *except upon the ground that the arbitrators went entirely outside the scope of the submission.''* (Italics supplied.) It is pointed out in *Hanley* v. *Aetna Ins. Co.,* 215 Mass. 425, 102 N. E. 641, 642, that there are various decisions in Minnesota, and one in South Dakota and one in Wisconsin, holding ''that referees appointed under a standard form of policy * * * should set as a quasi court and *decide the case* on the evidence offered by the parties,'' and the court then pointed out that ''the opposite conclusion, however, has been reached in every other state in which the question has arisen.'' (Citing a long list of authorities.) Thus it appears clear that the District Court here, by relying upon and following the *Titcomb* case, applied the old Minnesota rule (from which even Minnesota has receded in the case of *Ciresi* v. *Globe,* 187 Minn. 145, 244 N. W. 688) that fire insurance appraisers, under their policy form statute are ''common law arbitrators,'' when such is not and never has been the law of California.

In the *Chandos* case, *supra,* cited and relied upon by the District Court, it was simply held, so far as our question is concerned, that (p. 392) ''In general, *arbitrators* have full power to decide upon questions of law and fact, which directly or incidentally arise in considering and deciding the questions embraced in the submission. When not limited by the terms of the submission, they have authority to decide questions of law necessary to the decision of the matter submitted, *because they are judges of the parties' own choosing.''* That is the power of arbitrators, but we are here dealing with ''appraisers'' to ''estimate and appraise the amount of loss,'' —not with ''arbitrators'' to judge the controversy—and, by the submission, questions of policy interpretation and of law were not intended to be, and were not, submitted to the appraisers, but such questions were expressly withheld from them.

In the case of *Patriotic Order Sons of America* v. *Hartford Ins. Co., supra,* cited by the District Court,

the court held that findings of the amount of loss made by appraisers, *within* the submission, are binding. Of course, that would be true, but, as there pointed out by the court, if the appraisers did not value "all the items of loss" or "cover everything contemplated by the agreement," the award would not be binding, and the court said at p. 262, "The general rule undoubtedly is that, unless restricted by the agreement of submission, *arbitrators are the final judges of both law and fact, and an award will not be reviewed or set aside for mistakes in either.*" Such is the power of arbitrators, but the valuers here were appraisers, and the parties here did not intend to, and did not, submit to the appraisers questions of policy interpretation and of law, for determination, but intended to, and did, expressly withhold such questions from them.

We submit that the foregoing demonstrates that it was not the intention of the parties to empower, and they did not empower, the appraisers to interpret the policies and decide such and other questions of law, but, on the contrary, intended to, and did, expressly withhold such powers from the appraisers, and that, though there is no language—certainly no "plain language" or "clear and unmistakable terms"—in the appraisal clause authorizing the appraisers to interpret the policies and decide questions of law, or to do more than simply "appraise the loss," the District Court *implied* power in the appraisers to interpret the policies and to decide questions of law, with finality, and following the old Minnesota rule, as stated and necessarily followed by the Eighth Circuit in the *Titcomb* case, that appraisers under fire insurance policy are "common law arbitrators," held that the appraisers here were authorized by the parties to interpret the policies and decide questions of law, with finality. This was clear and vital error.

Having thus decided that the appraisers had power to construe the policies, determine questions of law and conclude the whole controversy with finality, the court had determined the case, and, we believe, it is only natural that this conclusion of the result greatly influenced

the consideration the court gave to the merits of appellant's three challenges upon the validity of the appraisers' report, and this we hope to demonstrate in the argument of those points.

II.

The court erred in holding that the fact that the appraisers "considered" the excess logging costs, the decking expense and the log depreciation, aggregating $91,439.34, and made a lump sum compromise allowance thereon of $25,000.00, constituted a proper discharge of their duties under the submission.

The amounts of these items set up in appellant's proof of loss were:

Excess logging costs after the fire	$42,797.04
Log decking expense	12,492.35
Log depreciation	36,149.95
Total	$91,439.34

The appraisers were to "appraise the loss." The word "appraise" means "To value property at what it is worth" (*Bouvier's Law Dictionary,* Third Revision). This means that the appraisers were to exercise their reasoned judgment in determining the full and true value of these items in money.

Instead of doing this, the appraisers undertook to act as judges and to construe the policies and their coverages, and, being doubtful whether the policies covered and insured these items, undertook to adjudicate them according to their own ideas of rough justice, and made, without any computations, an arbitrary lump sum compromise allowance of these items in the round sum of $25,000.00.

There was no dispute before the appraisers about the figures. The same figures were presented to the appraisers by appellees as were contained in appellant's proof of

loss, and it was agreed by all parties that these figures were the only figures necessary for the appraisers to consider.[46]

The appraisers in fact accepted the excess logging cost figure of $42,979.04 and the log decking figure of $12,492.35 and the log depreciation figure of $36,149.95,[47] but "there was a dispute between the appraisers as to whether these things should be allowed at all or not." The appraisers entertained the notion that inasmuch as appellant still had the logs on hand it would, by milling them, recover its cost for them "in the long run," and therefore "should absorb this cost."[48] Mr. Herrick held the view that the loss of worth in logs was "deterioration" and not "depreciation" within the meaning of that term as used in, and insured by, the policies,[49] and there was much discussion between the appraisers upon "the question as to the allowability of it (these claims) at all," and finally the appraisers, without making any kind of computation and without finding the amount of any of these items and without submitting their matters of disagreement to the umpire, agreed upon an arbitrary, lump sum, compromise allowance of $25,000.00 for these three items aggregating $91,439.34. On this point Mr. Herrick testified (R. 537):

> "Q. Was it arrived at by agreement?
> A. Yes.

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[46]See footnotes 11 and 12 on pages 17 and 18.

[47]See footnotes 13, 14 and 15 on pages 18 and 19.

[48]Mr. Herrick testified (R. 538, 539): "Q. Was it your idea that a part of the cost after the fire went into the logging, and they still had logs on the way, and for that reason they should absorb this cost? Was that the idea? A. Why, that is fundamental, Judge. Q. Well, am I right? A. Certainly you are right on that."

Mr. Maloney testified (R. 604): "Q. Do you remember what was done with that; whether it was allowed or not? A. No, not—as a single individual item, it was not. Q. Do you remember why it was not? A. There was a great deal of discussion in regard to excessive logging costs; and the values to them; and that there should be some recovery, but they would be benefited by it in the long run."

[49]Mr. Herrick testified (R. 540): "The so-called log stain was designated in the claim as depreciation; and if you will pardon me for saying so, Judge, that was not true. It was not a depreciation as the term is understood. It was deterioration, which was not a continuing expense."

Q.Was there a dispute between the appraisers as to whether these things should be allowed at all or not?

A. Yes.

Q. Is that what resulted in the agreement?

A. Yes.

Q. Was it a compromise?

A. You might call it—, yes, I think you would call it a compromise."

Mr. Maloney, referring to a sheet containing these items, with a bracket around them, and $25,000.00 written at the side in Mr. Herrick's handwriting, testified (R. 605):

"That means that we allowed $25,000.00 for the first four items on the sheet."

This is the uncontradicted testimony of the appraisers as to how they "considered" and treated with these items.

When one agrees that the value of his property or the amount of his loss shall be "appraised" by appraisers, he contemplates, and is entitled to expect, the reasoned judgment of the appraisers in finding the full and true value of his property in money. He authorizes nothing less. He does not authorize the appraisers to construe the contract, nor to adjudge his legal rights thereunder in accordance with their own ideas of the equities, nor does he authorize appraisers to make an arbitrary, round figure, lump sum, compromise of his rights, for certainly that is not an appraisement. Yet that is exactly what happened here.

The appraisers were not only unauthorized to construe the policies and to adjudge whether or not they covered these items, but, being laymen, lacked the special competence to do so, as shown by the legal notions they entertained.

In respect of the log depreciation, they entertained the notion that the company still had the logs on hand and, by milling them, would get its cost back "in the long run," and should therefore absorb the depreciation. This was

obvious error. When one suffers a loss on property insured against such loss, the question, with respect to the insurer's liability, is not whether he may nevertheless recover his cost in his operations. The question is, rather, did he have a loss that was insured, and, if so, the amount of it. Appellant had a value in these logs that was lost forever by depreciation. That loss was expressly insured by these policies. The word "depreciation" was specially put into the insuring provisions of the policies at the request of appellant. This is shown at R. 408, 409, as follows:

> "Q. * * * I ask you with respect to the use of that word 'depreciation' as included in ITEM II of the insuring clause: Was that word in the policies as originally furnished to Pickering?
>
> A. The first policy—
>
> Mr. Levit: Just a moment, I didn't understand that question at all.
>
> The Court: He is trying to bring out the point that as originally furnished, the policies didn't include the word 'depreciation.'
>
> Mr. Levit: You mean that the form was changed after the policies were originally issued?
>
> Mr. Whittaker: The policies were sent back and the insurance companies told that we wanted a specific coverage of depreciation, and the policies were accordingly altered and that word 'depreciation' was put in insuring ITEM II, where it appears in the typewritten portion of the policies now mimeographed in the exhibit before the Court.
>
> Mr. Levit: If counsel says that is the fact, I will stipulate to it.
>
> The Court: Well, that is stipulated to, then."

The loss of worth in these logs occurred through "depreciation." "Depreciation" was insured. This is true beyond debate.

Mr. Herrick's notion that the loss of worth in the logs was "deterioration" and not "depreciation" within the meaning of insuring "ITEM II" of the policies was likewise both beyond the submission and legally unsound. *Webster's Twentieth Century Dictionary* defines the word "deterioration" as "To make worse; to reduce the value

of; to reduce in worth,'' and the word ''depreciation'' is given as a synonym, which, of course, it is.

Not only were the appraisers unauthorized to adjudge the coverage of the policies, but moreover the notions they entertained in that respect were clearly wrong.

The district court said in his opinion (R. 116):

> ''Apparently in determining these three items the referees also considered that labor and material costs generally had risen, that labor was more inefficient, and that these factors made the logging cost greater than in similar periods in the past, and would have occurred had there been no fire.''

This overlooks the fact that any such issue had been removed from the case, because, as had been pointed out to the appraisers by the insurance companies, on page 3, 4th paragraph, of the Withers and Ball ''Memorandum to Appraisers'' (Deft's Ex. 3):

> ''* * * It was agreed with the assured that the experience of the fiscal year 1944-1945 should be used as a basis of the adjustment of the loss. *The purpose of such agreement, which benefited assured, was to avoid discussions and arguments as to increasing costs, decreasing labor efficiency, and increasing sales values during the period following the fire.''* (Italics supplied.)

The district court pointed out in his opinion (R. 115) that Mr. Herrick wrote in a letter (Plf's Ex. V) that ''a reasonable claim (for excess logging cost) probably would not have been more than $15,000 to $20,000.'' The appraisers were not commissioned to say what the item ''probably'' amounted to. Nor is there any statement as to what the decking expense of $12,492.35 and the log depreciation of $36,149.95 ''probably'' amounted to; but, if it be assumed that the excess logging costs did not amount to ''more than $15,000 to $20,000,'' would appellant also be bound by the assumption that the total of the decking expense and the log depreciation, aggregating $48,642.30, did not amount to more than the

$5,000 to $10,000 difference between the "probable" amount of the excess logging costs and the compromise allowance of $25,000.00?

The district court said in his opinion (R. 117, 118):

> "It is contended here that the appraisers did not *consider* or determine these three items, but the evidence is to the contrary. The testimony of Herrick, Maloney and Lilly show that they *considered* each of these items and that the allowance of $25,000.00 included the excess log cost, the log stain and the log decking." And said further (R. 118): "Accordingly it can not be said that the appraisers failed to *consider* or determine these three items." (Italics supplied.)

There can be no doubt the appraisers "considered" them. But they "considered" them of doubtful allowability, and being unable to agree upon "the allowability of them at all," abandoned their duties to "appraise," and find the true value of the items, but, instead, decided to adjudge them in accordance with their own ideas of rough legal justice, and they put them all in one package and made an arbitrary, lump sum, compromise of them in the round figure of $25,000.00. The court was clearly in error in holding that this constituted a proper discharge by the appraisers of their duties under the submission.

The invalidity of such an award has been clearly decided by the courts.

A case almost exactly in point is *St. Paul Fire & Marine Ins. Co.* v. *Eldracher,* 33 F. (2d) 675 (8th Cir.). There the court considered the validity of an appraisal made under the appraisal provisions of a fire policy identical with the appraisal provision here. An appraisers' award had been made, but despite it an action followed on the policy asking a larger sum. The insurers pleaded the award in bar. The insured replied, setting up (P. 677) "that the award did not express the judgment of the appraisers, but was made solely for the purpose and in the belief that it would be acceptable to both parties as a basis for settlement." This equitable issue

was heard and determined by the trial court without a jury. He held (P. 677-8) "that the appraisers were not able to agree on either item" (sound value or damage) "in their report and arbitrarily fixed those sums as a basis on which the loss could be settled, in the belief that both parties would be satisfied." On appeal, the 8th Circuit commented upon the fact that appraisers must act within "the scope of the submission," as follows (p. 678):

> "An arbitrator or appraiser has no power to act outside the scope of the submission. In the present case the only power delegated to Amber and McCormack as appraisers was to to state separately the sound value of the property and the damage thereto caused by the fire. They could do nothing else. They could decide upon nothing except the matters submitted to them. If they went beyond the submission, their award to that extent would be void, and if they wholly failed to pass upon the matters included within the submission their award, whatever it might be, would be wholly void."

The court then looked into what the appraisers had actually done to ascertain whether they had "acted beyond and outside the scope of the submission in making up their award," and on that point said (p. 679):

> "McCormack testified that after he and Amber examined the premises that each made their figures and were very far apart, so far apart there was no way of getting them together without a great deal of work, so they agreed to leave it to the umpire, and before the umpire was brought in and asked to serve he had a conversation with the Eldrachers and with other parties who he thought represented the insurance companies, or some of them, and received the impression that both sides would be willing to settle for $55,000.00; that thereafter he was not concerned about how the amount to be paid the Eldrachers should be arrived at, as long as they might get approximately $55,000.00; *that he and Amber never agreed on sound value or damage.*" (Italics supplied.)

Thereupon the appraisers got together and computed that the Eldrachers would receive approximately $55,000.00 by making up an award which stated sound value to be $100,000.00 and the damage to be $74,127.43, and they made their award accordingly. Of this action the court said (p. 679):

> "Clearly, this was an abandonment of any further effort to comply with the authority under the submission, and the award which they signed was in the exercise of power not conferred upon them."

There, as here, the appraisers "never agreed on sound value or damage." They did not, in our case, appraise the value of these items, but, as in the Eldracher case, being unable to agree on value, "abandoned any further effort to comply with the authority under the submission."

In *Holker* v. *Parker,* 11 U. S. 436, 7 Cranch 436, Mr. Chief Justice Marshall, speaking for the court, stated that the question to be decided, in determining whether an award of arbitrators was binding on the parties, was "whether this be, in fact, an award, in forming which the judgment of the arbitrators has been exercised, or a compromise wearing the dress of an award." As to the testimony of the arbitrator, the court said:

> "To the deposition of Mr. Lowell himself, great respect is due. He denies a compromise; but on examining his testimony, the court is of opinion, that his denial goes no further than to the form of an agreement. The facts he states prove one in substance * * *. He thought it his duty, he says, to secure even this sum for his client, rather than have an award that Parker owed him nothing; * * * This, then, is substantially a compromise, and not an award."

In our case, the compromise is not denied, but is positively shown and expressly admitted.

In the case of *Lee* v. *Providence Washington Ins. Co.,* 82 Mont. 264, 266 P. 640, appraisers appointed under a

fire policy to appraise the sound value of, and damage caused by fire to, a building, allowed physical depreciation of the building of 1.87% per annum during its life and then, in additon, allowed "commercal depreciation" of 10%. This action followed on the policies, and the appraisers' award was pleaded in bar. One of the appraisers, when asked to explain the "commercial depreciation," testified, "It is just simply a depreciation that we placed on the building to be less than 10 per cent. than what it would be in a growing—in a town where things were going along." The other appraiser testified that "you could not compute it at all." The Supreme Court of Montana held the award invalid, saying, p. 644:

> "But that the deduction of 10 per cent for 'commercial depreciation' was made without basis in fact or in law is clear." And said further (p. 645): "Appraisers can not arbitrarily fix a valuation upon property without regard to the character of the property. *Carlston* v. *St. Paul Fire & Marine Ins. Co., supra.* It follows that as a matter of law their action amounted to misconduct, misfeasance."

The fundamental error there, as here, is that the appraisers went outside the submission and attempted to resolve legal questions, of policy coverage and extent of liability, that were not submitted to them, and thus abandoned their duties, as appraisers, and made a gross mistake, and the parties are not bound by it.

In *Ciresi* v. *Globe & Rutgers Fire Ins. Co.,* 187 Minn. 145, 244 N. W. 688, appraisers were appointed, under the provisions of the policy, to appraise the loss or damage to an automobile that had been stolen for over a month and driven 8,600 miles. Necessary repairs were made at a cost of $201.00. The appraisers fixed that sum as the amount of loss or damage to the automobile. There had been substantial general depreciation of the car not made good by the repairs. "The appraisers construed the policy to limit plaintiff's recovery to the cost of repairs or replacement and to exclude anything additional for de-

preciation not made good by the repairs'' (p. 689). Of this action the Supreme Court of Minnesota said (p. 690):

> ''It was not for the appraisers to determine one way or the other the ultimate question of liability. Although they might consider it as a preliminary matter, their finding on a question of coverage, which would be a decision on a question of law, would not be final * * *. Their only function was to decide the simple fact issue as to 'the amount of loss or damage.' That was the only question submitted to them. It is plain that their award was not responsive to that issue. Knowingly, albeit in good faith, they omitted a major item of at least $600.00. Actual fraud was neither intended nor perpetrated. Yet there was a gross mistake which, unless rectified, will wrongfully deprive plaintiff of recovery for the substantial item in question.''

Again there, as here, the underlying error was that the appraisers did not discharge the submission, did not appraise the loss, but abandoned their functions, as appraisers, and undertook to construe the policy, and to adjudge the rights of the parties, according to their own ideas of the law and the equities.

In the case of *Tabor* v. *Craft,* 217 Ala. 276, 116 So. 132, there was a dispute between abutting land owners over the dividing property line, which was constituted in part by a river. The parties submitted to arbitrators the matter of determining ''the true location of Flint river.'' The arbitrators' report purported to fix the dividing property line, but did ''not locate Flint river as the boundary between the parties to the agreement.'' ''Their theory of the case was that, finding it impossible to trace the course of the river according to the field notes, they undertook to make an equitable division of the disputed area.'' Of this the court said:

> ''The report setting out the result of the arbitration, disclosing the fact that the arbitrators did not proceed in pursuance of the agreement of arbitration, *but according to their own idea of an equitable division between the parties,* the result is not

> binding upon appellant, and for the reason that the right of the parties and the duty and authority of the arbitrators must be measured by the terms of the submission."

The appraisers were authorized only to appraise the value of these items. The parties authorized nothing else. The appraisers did not appraise the value of any one of these items. The court does not find the contrary. Rather he finds they "considered" them and that, to some unknown extent, they entered into the $25,000.00 compromise allowance. "Consideration" of the items was not all the submission required. It required that the value of the items be appraised. Instead of appraising the value of these items, the appraisers undertook to construe the policies and to adjudge their coverage of these claims, and, entertaining erroneous legal notions making it doubtful, in their minds, that the policies covered these items, they undertook to adjudge them according to their own ideas of the law and rough justice, and put them all in one package and made an arbitrary, lump sum, compromise, allowance of them in the amount of $25,000.00, and thus both exceeded the submission and failed to discharge it, and appellant is not bound by what they did.

III.

The court erred in holding that the appraisers did not exceed, but properly discharged, the submission in rejecting appellant's actual cost, and in substituting OPA ceiling prices, for the lumber put through the box shook mill after the fire.

In the nine months loss period following the fire appellant milled 8,828,644 feet of its lumber, that had been graded as box lumber, into 8,636,974 feet of box shook, which it promptly sold.

> Appellant's actual cost for the box lumber to the point of diversion to the box factory— without a penny's profit being

allocated to operations prior to that diversion point—was	$39.86 per M	
Its cost of milling the lumber into shook was	11.65 per M	
Its under-run of 191,670 feet was	1.03 per M	
Its shipping costs were	.97 per M	
Its total actual cost for the shook was	$53.51 per M	
Its total actual realization for the shook was		$60.22 per M
Its total profit was	$ 6.71	
	$60.22	

$6.71 x 8,828,644 feet—all credited to appellees—$59,240.93.

Appellant had not produced this box lumber for sale, as lumber, and never offered it for sale, and it was not for sale, as lumber, but had produced and held it for the supply of its box shook mill for cutting into, and sale as, box shook.[50]

Because of war needs for shipping crates, or boxes, our government undertook to encourage the production and sale of box shook, and to discourage the sale of box lumber, as lumber, by setting OPA ceiling prices at a high figure for box shook and at a very low figure for box lumber, and as a result box lumber could not be purchased at OPA ceiling prices,[51] and, inasmuch as more than OPA ceiling prices could not lawfully be paid for box lumber, there was no "market" for box lumber where it could be both *bought* and sold, and no "market value" for box lumber, which means "a price established by public sales, or sales in the way of ordinary business, as merchandise * * * the price at which such articles are sold and purchased." (*Continental Rubber Works* v. *Bernson*, 91 Cal.

[50]See footnote 4 on page 11.

[51]See footnotes 5 and 6 on pages 11 and 12.

App. 636, 638, 267 P. 553, 554; *Valentin* v. *Valentin* (Cal. App.), 209 P. (2d) 654, 656.)

It may be well to point out that box shook is simple lumber which, instead of being sent, from the diversion point, to the planing mills for finishing into lumber for sale as lumber, is sent to the box mill where it is simply cut into smaller boards (R. 318 and 409). Though it is simply lumber, there were different and higher OPA ceiling prices applying to box shook than to lumber, for sale as lumber. The OPA ceiling prices were not alone a stated sum of money per thousand feet, but were a stated sum per thousand feet plus freight from a basing point—in this case the basing point was Susanville, California (R. 418).

Appellant had always milled its box lumber into, and sold it as, shook. That was the purpose of its shook mill. By doing so it was able to obtain a much better realization for its box lumber than by selling it as lumber. Nothing in these policies required appellant to sell its box lumber, as lumber, and to suffer the losses that would be entailed in doing so.

Yet the appraisers here ignored appellant's actual cost for the lumber of $39.86 per M, and ignored the fact that the box lumber was not for sale, as lumber, but was being held for finishing into shook, and indulged a theoretical sale of appellant's lumber, as box lumber, under OPA ceiling prices applicable to box lumber. They assumed the theoretical sale of half the box lumber for Merced, California, delivery, and the other half for Fresno, California, delivery, and averaged the freight salvage, from the basing point of Susanville, to the assumed delivery points of Merced and Fresno, and added that averaged freight salvage to the basic OPA price. Mr. Herrick testified (R. 546):

> "A. The constructed market price which was used was based on the sale—I think for half the quantity at Modesto for Merced delivery, at which point it would have given the company the greatest return; and the other half at Fresno, which gave it a little less return, and it was averaged out."

Thus, in these theoretical sales, the appraisers used exactly the OPA ceiling prices, and came out with a figure of $31.55 per thousand feet, which was $8.31 per thousand feet less than appellant's actual cost for the lumber, and thus they increased the amount of recovery, by partial operations of the box mill after the fire, from the actual amount of $6.71 to $15.02 per thousand feet, or by this $8.31 per thousand feet, or ($8.31 x 8,828,644 feet) $73,365.93, and hence improperly, and wholly fictionally, increased the figure for recovered fixed charges and expenses, by box mill operations, from the $59,240.93 credited by appellant, to $132,606.86, to appellant's injury, as a matter of law, in the amount of $73,365.93.

The appraisers "completely recognized that the OPA price on the quality and the grade of lumber that went through the box factory was less than the average cost of all lumber produced," and "it was within their general knowledge" that the box lumber could not have been purchased or replaced by appellant at OPA ceiling prices. They did not use OPA ceiling prices "on the theory that Pickering could have actually paid that." They used OPA ceiling prices upon the theory that appellant could not lawfully have sold that box lumber, as lumber, for a higher price, and because "it was the price that the law prescribed." To be specific on this point, we quote the testimony. Mr. Maloney testified (R. 613):

> "Q. Then why did you use the OPA? A. Standard price. The known price. *It was the price that the law prescribed,* and Mr. Herrick and Mr. Lilly stated that was the proper accounting practice."

At R. 614:

> "Q. It was what had been established by the government? A. Right. That is what we worked our price from.
> Q. *Was that the only consideration?* A. *That's right, as far as the price base was concerned.*
> Q. *There wasn't any other?* A. *Not to my knowledge.*" (Italics supplied.)

Mr. Lilly, the umpire, testified (R. 583):

> "A. I think there were two views there, as I recall; Mr. Herrick had one view, and asserted one view to the effect that he thought the material being there should carry a higher price than OPA price; and Mr. Maloney said—I think took the opposite viewpoint, that the OPA price was the price to be used.
> Q. Do you recall, in regard to that, making the decision? A. I think I acquiesced in the OPA price plus the agreed upon freight differential. I think that freight differential was Fresno and Merced or Fresno and Modesto; I can't tell which."

Mr. Herrick testified (R. 545):

> "A. The constructed market price *was the so-called legal price at which the lumber could have been sold* —that is, the lumber which was converted into—through the box factory—*could have been sold as lumber* plus the most advantageous freight differential.
> Q. Which, by the way, was a part of the OPA price, wasn't it?
> A. No, the OPA prices were on a basic point of Susanville to the point of destination, less the actual freight from Standard to the point of destination.
> Q. * * * If they had sold under OPA, they would have been permitted to sell it that way, wouldn't they?
> A. Yes.
> Q. In other words, the OPA prices being based at Susanville, if you could sell at places where the freight was less than that, you actually could make that freight differential by selling under the OPA?
> A. Yes." (Italics supplied.)

This testimony is so definite and specific as to leave no doubt that the appraisers indulged a theoretical sale of appellant's box lumber, as lumber, under OPA ceiling prices applicable to box lumber, and did so because "it was the price that the law prescribed," and was the price that "had been established by the government," and was "the so-called legal price at which the lumber could have been sold, as lumber," and that this was "the

only consideration'' and ''there wasn't any other'' consideration.

We believe this demonstrates that there is no evidentiary support for the statement, in the district court's opinion (R. 109), saying that the appraisers did not use OPA ceiling prices because they thought the law so required, but that ''they decided as a matter of practical and realistic accounting that OPA ceiling prices was the fairest, most practical and realistic method of costing the lumber into the box factory for the purposes of determining the profit from the box factory operations.''

Not only were the appraisers unauthorized, under the submission, to adjudge these questions of law, but that power was expressly withheld from them; but nevertheless they attempted to decide, and misdecided, an important question of law in holding that OPA ceiling prices governed, to appellant's injury in the amount of $73,-365.93. This matter has been made too clear for extended debate by the very regulations of the Office of Price Administration themselves, and by the numerous court decisions on the point.

The OPA regulations themselves say, about as plainly as words can, that OPA ceiling prices do not apply to ''the adjustment of losses made in connection with settlements of claims under policies of insurance.''

The court, in the case of *Sun Insurance Office* v. *Rupp,* 64 Fed. Supp. 533, 538 (D. C. Mo.), says that is what those regulations say and mean. It said ''the regulations promulgated by the Office of Price Administration provide that such rules and regulations shall not apply to settlements under policies of insurance.'' The court, in that case, had before it a suit upon a collision policy of insurance covering a truck which had been destroyed by collision. The insured claimed his cost for the truck. The insurer claimed that its liability could not exceed OPA ceiling prices. The court, after pointing out that Section 18 (e) of the order of the Office of Price Administration provides that ''the term 'sale' does not refer to the adjustment of losses made in connection with set-

tlement of claims under policies of insurance against fire, theft, collision, other loss of property or other coverage, even though the right of subrogation may be involved. The term 'seller,' 'selling,' 'purchase,' 'purchaser' and 'purchasing,' shall be construed accordingly,'' and, after holding, as we have quoted, that OPA prices do not apply to settlements under insurance policies said further:

> ''However, it seems to me that the court is definitely confronted with the proposition of how the actual cash value under conditions as they existed at the time of the loss under the Emergency Price Control Act might be arrived at.
>
> The insured found himself in the anamolous position that settlements and adjustments for loss arising under policies of insurance were specifically excluded from the provisions of the Emergency Price Control Act of 1942, 50 U. S. C. A. Appendix, Secs. 901, *et seq.,* yet by that Act the normal market value of all equipment like that insured had been completely destroyed and all prices arbitrarily fixed by law, which it would seem rendered inapplicable the construction placed by the courts upon the phrase 'actual cash value.'
>
> We are faced with the problem that there was no market price for such equipment other than the ceiling price established by the Office of Price Administration, and the very Act which created those ceiling prices specifically exempted adjustments under policies of insurance from the provisions of the Act. Had the owner of this property gone out into the open market and sold the equipment for an amount in excess of these ceiling prices, as heretofore stated, he would have been liable not only to the person to whom he sold it for severe penalties, but would also have subjected himself to criminal prosecution.
>
> We must therefore find some other way of arriving at the actual cash value of the destroyed property. The owner testified that the equipment was essential to the conduct of his business and that he was not able to acquire equipment elsewhere at any price.''

The court concluded by allowing the plaintiff to recover his cost for the destroyed truck.

In the case of *Tierney* v. *General Exchange Ins. Corp.*, 60 Fed. Sup. 331 (D. C. Tex.), the District Judge had before him an action upon a fire insurance policy covering an automobile. The insured claimed his cost for the same, of $3,384.00. The insurer claimed its maximum liability was the OPA ceiling price, of $1,600.00. The court, in deciding the issue, said (P. 332):

> "We must bear in mind that the War Powers Act, 50 U. S. C. A. Appendix, Secs. 631, *et seq.*, was for the purpose of curbing, lessening and preventing inflation, so far as legislation could or can accomplish that end. In order to make regulations under it legally effective, it was necessary that they should be sufficiently specific to cover the transactions at which they were aimed. The particular schedules pertinent to this study concern the 'sale, or delivery' of used cars. There is no apparent reasonable stretch of the regulations which would cover an 'adjustment for insurance' losses. *In truth, there is a phrase in the regulations which excepts such efforts from the regulation.* Nor is there anything in the act or regulations which compels the owner of property to dispose of it. The owner who has paid for an automobile and who does not see fit to 'sell' that automobile, or to 'deal' in it, ought not to be classified as a 'seller' or 'dealer' if and when he seeks pay from an insurance company which has collected a premium from him and agreed to pay him for the fire loss of his property. Such an event does not classify him as either a 'seller' or a 'dealer.' He has not been identified in any of the regulations under the Act, and *seems to have been excepted from their operation.*" (Italics supplied.)

The above case was appealed to the Fifth Circuit, *General Exchange Ins. Corp.* v. *Tierney,* 152 F. (2d) 224. The court disposed of the appeal, saying:

> "The War Powers Act, 50 U. S. C. A. Appendix, Secs. 631 *et seq.*, was for the purpose of curbing and preventing inflation. To accomplish such purpose it fixed a ceiling price on the class of cars here under consideration of $2,000 for purchase or sale. It no-

where attempts to regulate or control adjustments for insurance loss. Moreover, it does not attempt to measure or fix value in setting up a price to be paid when such cars are bought and sold. Tierney was a traveling man, and his car was not for sale; and the regulations do not compel him to dispose of his automobile. He was not in the business of 'selling' or 'dealing' in automobiles, and the Act does not classify him as such. He has not been identified in any of the regulations under the Act, and we are of opinion that he has been exempted and excepted from its operation. The promulgation of the Price Administrator on July 10, 1944, was designated as Regulation MPR 540 and is as follows:

'(c) "Sale" includes sales, dispositions, exchanges, and other transfers and contracts and offers to do any of the foregoing. It includes conditional sales and sales under rental contracts, lease agreements or other agreements. It also includes transfers by banks, finance companies, or other persons discounting promissory notes following the taking of possession by such persons upon default of the person making such promissory notes. The term "sale" does not refer to the adjustment of losses made in connection with settlements of claims under policies of insurance against fire, theft, collision, other loss of property or other coverage, even though the right of subrogation may be involved. The terms "sale," "seller," "selling," "purchase," "purchaser," and "purchasing" shall be construed accordingly.'

The ceiling price fixed by the Office of Price Administration and which has just been adverted to, is not controlling in this case."

The same question has been up for decision time after time and, so far as our research discloses, has, each time, been decided in the same way. The other cases holding that OPA ceiling prices do not apply to the adjustment of insurance losses are: *Southern Railway Co.* v. *Farmer,* 74 Ga. App. 329, 39 S. E. (2d) 714; *Ross Produce Co.* v. *Thompson,* 236 Iowa 863, 20 N. W. (2d) 57; *Louisville & N. R. Co.* v. *Blanton,* 304 Ky. 127, 200 S. W. (2d) 133; *Brock* v. *Cato,* 75 Ga. App. 79, 42 S. E. (2d) 174; *Ablon* v. *Hawker* (Tex. Civ. App.), 200 S. W. (2d) 265; *Betts* v.

Hitchcock (Tex. Civ. App.), 197 S. W. (2d) 878; *Zemel* v. *Commercial Warehouses,* 132 N. J. L. 341, 40 A. (2d) 642; *Anstine* v. *McWilliams,* 24 Wash. (2d) 230, 163 P. (2d) 816; *Lym* v. *Thompson* (Utah), 184 P. (2d) 667; and *Fugate* v. *State,* 80 Okla., Cr. R. 200, 158 P. (2d) 177.

No other result is possible when it is realized, as stated by these cases, that the regulations of the Office of Price Administration themselves expressly provide that OPA ceiling prices shall not apply to the adjustment of insurance losses.

It is clear beyond debate that the appraisers exceeded the submission by attempting to determine the law, and erred, in rejecting defendant's cost for the box lumber, used in the box mill, and in deciding that the law required that lumber to be charged, and in charging it, to the box mill at the amount for which it could lawfully have been sold as box lumber, at the date of the fire, under OPA ceiling prices applicable to box lumber, and, in so exceeding the submission, and in so misdeciding this question of law, the appraisers deprived appellant of $73,365.93.

The District Court remarked in his opinion (R. 112) "* * * that in making a claim against the insurer of the property destroyed by fire the defendant based its claim for the lumber destroyed on OPA ceiling prices, though the average cost was available." The court has failed to remember, or to understand, that the small amount of lumber which was burned, and for which claim was made under the direct fire policies, was in the process of being sawn in the sawmill, which burned, and that this lumber had not been sorted and, after it had burned, no one could tell what, if any, part of it would have been sorted and assigned as box lumber for cutting into, and sale as, box shook (R. 409, 410, 429), and therefore it all had to be treated *as lumber, for sale as lumber,* and having to treat it *for sale as lumber,* obviously, it could not lawfully have been sold for more than OPA ceiling prices applicable to lumber, and it was for that reason that it was included in the direct fire loss claim at what it would have brought, *as lumber,* and, on that matter, its cost was immaterial.

But, had it been box lumber, it would not have been intended to be sold, nor for sale, *as lumber,* under OPA ceiling prices or otherwise, but would have been intended to be sold, and for sale, only as *box shook,* and, naturally, in determining "profits" made by the box shook mill, under a use and occupancy policy, the *cost* of the box lumber—not what it could have been sold for, *as lumber*—would be the basically material factor.

In the District Court's opinion it is said (R. 109) "It is generally conceded that this" (OPA price) "was more favorable to the defendant than an allocated cost, if that could be determined."

The error of this statement lies in the failure to keep in mind the distinction between box lumber, as lumber, on the one hand, and box shook, on the other hand. The theory of allocated costs—and it is entirely a theory—is that the same rate of profit is to be realized from every product, and to produce that result selling prices are first assumed, and the total of all costs of all products are then apportioned or allocated to the several products on the basis of their assumed selling prices, and thus allocated costs are theoretically determined (R. 261, 262, 450, 451, 455). Therefore, if it be assumed that box lumber was to be sold *as box lumber* under OPA prices, then inasmuch as OPA prices *for box lumber* had been purposely fixed very much lower (to encourage the making of box shook) than for finished commercial lumber, allocated costs would be less than OPA prices *for box lumber* (R. 401). But, when we realize that appellant never did sell *box lumber* (its cost of producing it being $8.51 per M more than OPA prices for it), but produced it only to be cut into and sold as shook, and look at the actual facts, we see that, in the test year, appellant's realization from all its finished commercial lumber was $45.12 per M, but its realization for all its shook was $51.90 per M (R. 413, 414), and therefore theoretical allocated costs for the *shook* would be a great deal more than OPA prices for *box lumber* and even more than appellant's actual cost for the box lumber (R. 392). Hence it is not correct to

say that the OPA price "was more favorable to the defendant than an allocated cost, if that could be determined."

But there is no point in discussing allocated costs because the appraisers did not use them. Moreover, it is obvious, and agreed by all, that when all the products have been sold and actual realizations are known you come out at the same place whether you use actual, or a theoretical, cost (R. 274, 415, 456). Here all the box lumber was actually milled into shook and all the shook was actually sold, and actual realizations were determined, before expiration of the loss period, and, of course, long before the proof of loss was filed, and therefore, having the actual facts, there is no excuse for theorizing what they might have been.

Judge Parker said, in his excellent opinion in the use and occupancy insurance case of *Fidelity Phenix Fire Ins. Co.* v. *Benedict Coal Corp.,* 64 F. (2d) 347, 352 (4th Cir.), that "such losses are to be determined in a practical way." These policies were to protect appellant against actual loss. To the extent it made actual profits in partial operations after the fire, it did not have actual loss. What profits did it actually make out of operations of the box shook mill after the fire? Its actual cost for the box lumber to the box mill door—without a penny's profit to that point—was $39.86 per M. Its actual costs of cutting the lumber into shook and shipping and selling it were $13.65 per M. It actually got for it $60.22 per M. It, therefore, made an actual profit of $6.71 per M or ($6.71 X 8,828,644 feet) $59,240.93, all of which it credited to the insurance companies. These are the undisputable actual facts.

Yet the appraisers, by ignoring appellant's actual cost for the lumber of $39.86 per M, and by indulging a fictional sale of the box lumber—that was not for sale, and that appellant was not required to sell and did not sell, as lumber—at the OPA price, applicable to box lumber, or $31.55 per M—or at $8.31 per M less than appellant's actual cost for that lumber—calculated an increase (wholly

unreal) in the recovery from box mill operations from $6.71 to $15.02 per M, or by said $8.31 per M, or ($8.31 X 8,828,644 feet) $73,365.93, which they further credited to the insurance companies, making a total credit to the insurance companies from partial operations of the box mill of 132,606.86, and thus visited an actual loss upon appellant in the amount of $73,365.93, which did not in very truth occur and which it could never recover.

The submission did not authorize the appraisers to adjudge questions of law, but, on the contrary, it expressly withheld that power from them, and the appraisers were told, in writing, by appellees, that if they ran into questions of law, their findings "should be in such form and detail that either interpretation of the coverage or liability could be applied" by others. Yet they departed from the submission and applied their own notions that the law required that the box lumber be charged to the box mill at OPA ceiling prices, applicable to box lumber, and, following that theory of the law, they indulged a theoretical sale of the box lumber, as box lumber, under OPA ceiling prices, despite the fact they realized, as they testified, that this lumber was not for sale, as lumber, and that this price was substantially less than appellant's actual cost for the lumber. The law did not so require. It expressly prohibited this. By thus exceeding the submission and erroneously interpreting and applying the law, they made a palpable mistake to appellant's injury in the amount of $73,365.93. One cannot profitably elaborate a truth so simple.

IV.

The court erred, as a matter of law, in holding that the appraisers properly added to annual values unreal depreciation on the destroyed sawmill for the year following its destruction by fire.

Numbered paragraph 4 of plaintiff's Exhibit B, the mimeographed part of the policies that provides the use and occupancy insurance, contains the following contribution clause:

> "4. 'CONTRIBUTION CLAUSE'—It is expressly stipulated and made a condition of this contract that, in the event of loss, this company shall be liable for no greater proportion thereof than the amount hereby insured bears to seventy-five per cent (75%) of the total of the net profits (ITEM I) and charges and expenses (as specified in ITEM II), which would normally have been earned during the period of twelve (12) months immediately following the fire."

Though appellant, in using the figures of the agreed test year in computing profits prevented, as set forth in its proof of loss, naturally, gave effect to depreciation on its sawmill (that was destroyed by the fire), the appraisers, nevertheless, in their finding of annual values—but not in their finding of values in the nine months loss period—, included depreciation on the destroyed sawmill for the year following the fire, of $15,042.17, thus reducing appellant's claim, under application of this contribution clause, by more than $8,000.00, when, in fact, and in law, no depreciation continued, or occurred, on the destroyed sawmill in the year following its destruction by fire.

The contribution clause of the policies only required inclusion in the values—both for the nine months loss period and for the one year period—, of "charges and expenses (*as specified in ITEM II*) which would normally have been earned during the period of twelve (12) months immediately following the fire," which clearly means—see "ITEM II" of the policies—such "*fixed charges and expenses which must necessarily continue during a total or partial suspension of business.*" Of course, depreciation on the sawmill did not continue after its destruction by fire.

The same thing was tried by the insurance company in the case of *Fidelity-Phenix Fire Ins. Co.* v. *Benedict Coal Corp.*, 64 F. (2d) 347, 353, and the court disposed of the point as follows:

> "And we agree with the learned judge in his dealing with depreciation and depletion under the heading of fixed charges. Depreciation on property which

has been destroyed is not to be allowed as a fixed charge, even though it must be considered in estimating profits which would have been earned if the business had gone on; for manifestly property which has been destroyed cannot depreciate."

Though appellant, in the computation of its profits prevented, had, necessarily, by using the figures of the agreed test year, given effect to depreciation on the sawmill—in both the nine months loss period and in the year period—, the appraisers, nevertheless, in their finding of annual values—but not also in their finding of values for the nine months loss period—, included a fictional depreciation on the destroyed sawmill which did not occur, and, thus wrongfully increased annual values by $15,042.17, which deprived appellant, under application of the contribution clause, of more than $8,000.00. This was clear error of law, to appellant's prejudice in that amount.

To demonstrate, in simple terms, how this error of the appraisers, in construing the policies, and their coverages, penalized appellant, we will set down the figures, and apply them under the formula of the contribution clause.

The proof of loss shows:

	Insured Period	Annual Period
	7-8-45 - 4-7-46	7-8-45 - 7-7-46
Profits prevented ITEM I	$266,241.60	$358,458.56
Continuing Costs ITEM II	$538,927.93	$646,190.47
	$805,169.53	$1,004,649.03
Less profits from partial operations—Sch. III	(63,165.12)	
	$742,004.41	

Application of "Contribution Clause"
75% of $1,004,649.03 equals $753,586.77
$753,586.77 into $742,004.41 equals 98.4631%
98.4631% X (ins) $651,000.00 equals $640,994.78.

The above figures in the proof of loss representing "profits prevented" were the results after all depreciа-

tion, including depreciation on the sawmill of $11,281.62 for the nine months, and $15,042.17 for the year, had been deducted. If those amounts had not been there deducted the figures respecting profits prevented would have been $277,523.22 for the nine months and $373,500.73 for the year.

ITEM I of the insuring clause insured the profits prevented. ITEM II of the insuring clause insured the charges and expenses "which must necessarily continue" after the fire. Depreciation did not continue on the destroyed mill after it was burned, and therefore should not have been included (and was not included by appellant, either in the figures for the nine months or for the year) in the insured charges and expenses that "must necessarily continue" after the fire.

The appraisers added to the annual values (but nothing to the nine months values) the sum of $15,042.17 as depreciation on the sawmill in the year after the fire.

The effect of this is to alter the figures thus:

	Insured Period	Annual Period
Profits prevented ITEM I	$266,241.60	$358,458.56
Continuing costs ITEM II	538,927.93	646,190.47
Here insert the appraisers error		15,042.17
		$1,019,691.20
Less profits from partial operations—Sch. III	(63,165.12)	
	$742,004.41	

Application of "Contribution clause"
75% of $1,019,691.20 equals $764,768.40
$764,768.40 into $742,004.41 equals 97.234%
97.234 X (ins) $651,000.00 equals $632,993.34.

Hence the amount of appellant's recovery is reduced by that error, of including depreciation on the destroyed sawmill, in the amount of $15,042.17, for the year following the fire, and which depreciation did not, of course,

continue, by the difference between $640,994.78 and $632,-993.34, or by $8,001.44.

It seems clear enough that the policies only required inclusion, in these values, of "charges and expenses (as specified in ITEM II) which would normally have been earned during the period of twelve months immediately following the fire" and this means, as recited in ITEM II, such "fixed charges and expenses which must necessarily continue." But even if there be any doubt about it, certainly the policy is subject to that interpretation, and "where the provisions of an insurance policy are subject to two or more interpretations, that which is adverse to the insurance company must prevail." *General Insurance Co.* v. *Pathfinder Petroleum Co.,* 145 F. (2d) 368, 370 (9th Cir.).

We contend that inasmuch as ITEM II of the insuring clause of the policies limits inclusion in continuing charges and expenses to those "which must necessarily continue," that there is no basis for including a fictional depreciation on the sawmill after it was destroyed by fire, *but this much is true to a moral certainty,* if a fictional depreciation on the destroyed sawmill is to be included in the one year's charges and expenses ("that must necessarily continue"), even though it did not continue, then 75% of it would have to be included in the nine months period and the figures then would be:

	Insured Period	Annual Period
Profits prevented ITEM I	$266,241.60	$358,458.56
Continuing costs ITEM II	538,927.93	646,190.47
Add depreciation on burned mill	11,281.62	15,042.17
	$816,451.15	$1,019,691.20
Less profits from partial operation—Sch. III	$ 63,165.12	
	$753,286.03	

Application of "Contribution Clause"
75% of $1,019,691.20 equals $764,768.40
$764,768.40 into $753,286.03 equals 98.498%
98.498 X (ins) $651,000.00 equals $641,221.98.

Hence, if the appraisers had been consistent in their error, in construing this provision of the policies, appellant would have received, through the error, more than it claimed, to the extent of the difference between this $641,221.98 and the $640,994.78, computed under its proof of loss, or $227.20, and would have received $8,228.64 more than found by the appraisers.

We believe this demonstrates to a mathematical certainty, that the appraisers exceeded the submission in attempting to construe the policies and that they erred in their construction of the policies, in this respect, to appellant's injury in the amount of $8,001.44.

Before concluding, we desire to make mention of the fact that the court, in his opinion, says that the total of the claims about which appellant complains do "not exceed 15% of the total claim" (R. 104). This argument was made to the court by appellees numerous times during the trial, but, believing the matter unworthy of any serious consideration, we made no reply. But, now that the court has accepted the figure and remarked of it, we want to answer briefly.

The amount about which appellant is complaining is (excess logging costs, log decking expense and log depreciation, $91,439.34, less the $25,000.00 compromise allowance, or $66,439.34, plus the erroneous increase in box mill profits of $73,365.93, plus the erroneous inclusion in annual values of depreciation on the destroyed sawmill of $8,001.44) the sum of $147,806.71. The amount of loss in the nine months insured loss period, as set forth in the proof of loss, was $742,004.41. The amount appellant is complaining about of $147,806.71 is 19.92% of the amount set forth in the proof of loss. But, when the proof of loss goes through the formula of the contribution clause, the real amount of the claim as set forth in the proof of loss became $640,994.78 and the amount appellant is here complaining about of $147,806.71 is 23% of that amount. The amount payable under the appraisers' award, after application of the contribution clause, is $491,379.41 and the

amount which appellant is here complaining about of $147,806.71 is 30% of that amount.

Whatever the percentages, $147,806.71 is, to us, a very substantial sum of money, and appellant, having bought and paid for insurance that covered it, thinks it is entitled to collect it.

Conclusion.

In conclusion, we respectfully submit that, for each and all of the foregoing reasons, the judgment of the District court should be reversed and appellant allowed to proceed to try its case before a jury under Count II of its counterclaim.

Respectfully submitted,

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